Supreme Court, U.S.
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CASE NO. OFFICE OF THE CLERK

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1994

EDSEL ADAMS AND FRANCES T. ADAMS, Petitioners

v

BARCLAYS/AMERICAN BUSINESS CREDIT, INC.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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118 pp

QUESTION PRESENTED

WHETHER A PARTY SEEKING AN OUTRIGHT DENIAL OF A DEBTOR'S DISCHARGE PURSUANT TO § 727(a)(2) OF THE BANKRUPTCY ACT MUST PROVE HIS CASE BY "CLEAR AND CONVINCING EVIDENCE," OR WHETHER THE OBJECTING PARTY IS MERELY REQUIRED TO PROVE HIS CASE BY A "PREPONDERANCE OF THE EVIDENCE," THE STANDARD OF PROOF REQUIRED OF A PARTY SEEKING ONLY AN EXCEPTION OF HIS DEBT FROM THE DEBTOR'S DISCHARGE PURSUANT TO § 523(A) OF THE BANKRUPTCY ACT?

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OPINIONS RENDERED IN THIS CASE BY OTHER COURTS

This Petition seeks review of the August 3, 1994 judgment of the United States Court of Appeals for the Sixth Circuit (the "Court of Appeals") regarding the standard of proof required in a denial of discharge proceeding under § 727(a)(2) of the Bankruptcy Act. (Appendix F, infra.). The August 3, 1994 judgment of the Court of Appeals has been officially reported as In Re: Adams, 31 F.3d 389 (6th Cir. 1994). Rulings in this case leading up to the judgment of the Court of Appeals are set forth as follows:

A. Initial Ruling of the Bankruptcy Court.

On June 18, 1986, after a lengthy bench trial, a Memorandum Opinion and Order was entered by the Bankruptcy Judge in the United States Bankruptcy Court for the Western District of Tennessee (the "Bankruptcy Court"),

denying the Petitioners' Discharge in bankruptcy pursuant to 11 U.S.C. § 727(a)(2)(A) & (B). (Appendix A, infra.). On June 27, 1986, the Bankruptcy Judge entered a judgment denying the Petitioners' Discharge and awarding a money judgment against the Petitioners and in favor of Barclays/American Business Credit, Inc. ("Barclays") in the amount of $737,367.74 plus interest (the "Money Judgment"). (Appendix B, infra.). On January 10, 1992, the Bankruptcy Court entered an order, *nunc pro tunc,* denying the Petitioners' Motion To Reopen Case, For New Trial, and To Disqualify Judge. (Appendix C, infra.). The Petitioners had filed that motion on November 24, 1986, after first learning that, before and after the trial of this case, the Bankruptcy Judge had filed affidavits about the Petitioners at the request of their former counsel in a disciplinary action that the Petitioners were pursuing against their

former counsel before a state administrative body. On February 23, 1987, the Bankruptcy Judge announced that he was denying the Petitioners' Motion. On March 4, 1987, the Order that was formally entered on January 10, 1992 was submitted for entry. When the record was being prepared by the Bankruptcy Court for transmission to the United States District Court for the Western District of Tennessee (the "District Court") the original Order signed by the Bankruptcy Judge was not located.

B. Ruling of the District Court on Initial Appeal. On January 30, 1992, an Order was entered in the District Court affirming the Bankruptcy Court's denial of the Petitioners's discharge and award of a nondischargeable judgment against the Petitioners. (Appendix D, infra.). Pursuant to that Order, this case was remanded to the Bankruptcy Court to conduct further proceedings on the award of the attorneys'

fees that had been included in the Money Judgment. A Judgment in a Civil case confirming the District Court's January 30, 1992 ruling was filed on February 25, 1992.

C. **Ruling of Bankruptcy Court on Remand**. On November 24, 1992, the Bankruptcy Court, at the request of Barclays, entered an Order Amending Judgment Entered June 27, 1986, reducing the amount of the requested attorneys' fees and accordingly reducing the amount of the Money Judgment to $686,227.14. (Appendix E, infra.).

D. **Ruling of District Court on Second Appeal**. On March 17, 1993, the District Court amended its January 30, 1992 ruling incorporating the Bankruptcy Court's November 24, 1992 ruling, reducing the amount of the Money Judgment, and certifying the amended judgment as final for purposes of appeal.

E. **Ruling of Court of Appeals**. On August 3, 1994, the Court of Appeals affirmed the District Court's decision that the

Bankruptcy Court's denial of the Petitioners' Discharge and entry of the Money Judgment was appropriate. (Appendix F, infra.) In reaching its conclusions, the Court of Appeals, followed this Court's ruling in Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991), and ruled that in order to obtain the denial of the Petitioners' discharge, Barclays was only required to prove its case by a "preponderance of the evidence," rather than by "clear and convincing evidence

STATEMENT OF JURISDICTION

On October 9, 1984, the Petitioners filed a voluntary proceeding in the Bankruptcy Court pursuant to Chapter 7 of the Bankruptcy Act (11 U.S.C. §§ 1 et. seq.). This case was commenced as an adversary proceeding in the Bankruptcy Court on May 11, 1985, when Barclays sought to have the Petitioners' discharge denied pursuant to 11 U.S.C. §§ 727(a)(2)(A) & (B). The judgment and order of the Court of Appeals in this case, which is the subject of this Petition for Writ of Certiorari, was entered August 3, 1994. (Appendix F, infra.). No rehearing by the Court of Appeals was requested or conducted. 28 U.S.C. § 1254(a) confers jurisdiction on this Court to review the judgment of the Court of Appeals by writ of certiorari.

CONSTITUTIONAL PROVISIONS AND STATUTES

APPLICABLE TO THIS CASE

CONSTITUTION OF THE UNITED STATES, Article I, Section 8, Clause 4

> The Congress shall have power...to establish...uniform laws on the subject of bankruptcies throughout the United States...

CONSTITUTION OF THE UNITED STATES, Amendment V, (Due Process of Law)

> No person shall...be deprived of life, liberty or property, without due process of law...

11 U.S.C. § 727 DISCHARGE

(a) The court shall grant the debtor a discharge, unless

***

(2) the debtor, with intent to hinder, delay or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed -

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of filing of the petition;

***

STATEMENT OF CASE

On October 9, 1984, the Petitioners, Edsel Adams and Frances T. Adams, husband and wife, filed their voluntary Chapter 7 Bankruptcy proceeding. Prior thereto, the Petitioners had been involved through various closely held corporations in the manufacturing and marketing of plywood in Alabama, Arkansas, and Tennessee. On July 26, 1983, the Petitioners' corporation, Adams Plywood, Inc., had entered into a financing relationship with Barclays, pursuant to which Barclays advanced operating capital to Adams Plywood, Inc. in return for collateral pledges of inventory and accounts receivable.

As a result of cash flow problems, Adams Plywood, Inc. filed a voluntary Chapter 11 Bankruptcy proceeding on August 22, 1984. Barclays immediately made demand upon the Petitioners to pay the obligations of Adams

Plywood, Inc., resulting in the Petitioners filing their voluntary Chapter 7 Bankruptcy proceeding. After auditing the inventory and accounts of the Petitioners' closely held corporations and after liquidating collateral in which it claimed security interests, Barclays filed suit in the Bankruptcy Court alleging that the Petitioners had violated the provisions of §§ 727(a)(2)(A) & (B) of the Bankruptcy Act. Barclays asked the Bankruptcy Court to determine the Petitioners' debt under their guarantees to be nondischargeable and to deny the Petitioners' discharge. The Petitioners, who had turned over all of their non-exempt property to their Court appointed trustee, denied that they had violated the provisions of § 727 of the Bankruptcy Act and asserted that they were entitled to receive a discharge all of their debts.

After extensive discovery and after a lengthy trial in which over 200 trial

exhibits were introduced, the Bankruptcy Judge took the case under advisement. On June 16, 1994, the Bankruptcy Judge entered a Memorandum Opinion and Order in which he ruled that the Petitioners' discharge would be denied and that Barclays was entitled to a nondischargeable judgment. (Appendix A, infra.).

Prior to the commencement of discovery in this case, the Petitioners had terminated their representation by their original Bankruptcy counsel and had retained new counsel for the trial of this case. After representation by their original Bankruptcy counsel was terminated, the Petitioners filed a pro se disciplinary complaint against them with Tennessee's Board of Professional Responsibility (the "Administrative Action"). This case, as well as in the Administrative Action, proceeded concurrently. Subsequent to the entry of the Bankruptcy Court's judgment against them, the Petitioners

learned for the first time that the Bankruptcy Judge had executed affidavits about them at the request of their former Bankruptcy counsel. The Petitioners learned that those affidavits had been filed in the Administrative Action, both before and after the trial of this case. The Petitioners then moved the Bankruptcy Court to reopen this case, to order a new trial and to disqualify the Bankruptcy Judge. The Petitioners alleged that because he had executed and filed affidavits about them, and thereby, their credibility, the Bankruptcy Judge's impartiality should have been questioned. The Petitioners's Motion was denied by the Bankruptcy Judge, and all matters were appealed to the District Court.

The ruling of the Bankruptcy Court denying the Petitioners's discharge and awarding Barclays a substantial money judgment has now been affirmed by both the District Court and the Court of Appeals.

Both of those Courts found that the Bankruptcy Court, in determining whether the Petitioners's discharge should be denied, applied a "preponderance of the evidence" standard. The Petitioners had argued that because of the seriousness involved with the denial of their discharge, the appropriate standard of proof should have been "clear and convincing evidence." Both of those Courts cited this Court's decision in Grogan v. Garner, which involved a § 523(a) exception to discharge, as opposed to a § 727(a)(2) denial of discharge, as authority for the rule that "preponderance of the evidence" is the appropriate standard of proof in determining whether a discharge should be denied under § 727(a)(2) of the Bankruptcy Act.

ARGUMENT

A. Introduction.

By permitting a more relaxed standard of proof (i.e. "preponderance of the evidence") in deciding denial of discharge questions, the Court of Appeals has joined with other Circuits in sanctioning a departure from the accepted and usual course of judicial proceedings of requiring proof "clear and convincing evidence" in deciding denial of discharge questions, so as to call upon this Court's power of supervision. Furthermore, the Court of Appeals has gone beyond this Court's ruling in Grogan v. Garner, that "preponderance of the evidence" was the appropriate standard of proof in deciding exception to discharge, as opposed to denial of discharge, questions, to decide an important question of federal law which has not been, but should be, settled by this Court.

B. **Standards of Proof and Their Applicability.**

This Court analyzed various standards of proof and under what circumstances they were to be applied in Addington v. Texas, 441 U.S. 418, 99 S.Ct. 1804, 60 L.Ed.2d, 333, 99 S.Ct. 1804 (1979). The function and purpose of the concept of standard of proof was stated to be as follows:

> The function of a standard of proof, as that concept is embodied in the Due Process Clause and in the realm of factfinding, is to "instruct the factfinder concerning the degree of confidence our society thinks he should have in the correctness of factual conclusions for a particular type of adjudication." In re Winship, 397 U.S. 358, 370, 90 S.Ct. 1068, 1076, 25 L.Ed.2d 368 (1970) (Harlan, J., concurring). The standard serves to allocate the risk of error between the litigants and to indicate the relative importance attached to the ultimate decision.
>
> Id., 441 U.S. 423

The following standards of proof and their respective applications were recognized in Addington v. Texas:

> Generally speaking, the evolution of this area of the law has produced across a continuum three standards or levels of proof for different types of cases. At one end of the spectrum is the typical civil case involving a monetary dispute between private parties. Since society has a minimal concern with the outcome of such private suits, plaintiff's burden of proof is a mere preponderance of the evidence. The litigants thus share the risk of error in roughly equal fashion.
>
> ***
>
> The intermediate standard, which usually employs some combination of the words "clear," "cogent," "unequivocal," and "convincing," is less commonly used, but nonetheless "is no stranger to the civil law." Woodby v. INS, 385 U.S. 276, 285, 87 S.Ct. 483, 488, 17 L.Ed.2d 362 (1966). See also McCormick, Evidence § 320 (1954); 9 J. Wigmore, Evidence § 2498 (3d ed. 1940). One typical use of the standard is in civil cases involving allegations of fraud or some other quasi-criminal wrongdoing by the defendant.
>
> Id., pp. 423-424

This Court also recognized that the application of the "clear and convincing evidence" standard should be required in certain special types of civil cases:

> The interests at stake in those cases are deemed to be more substantial than mere loss of money and some jurisdictions accordingly reduce the risk to the defendant of having his reputation tarnished erroneously by increasing the plaintiff's burden of proof. Similarly, this court has used the "clear, unequivocal and convincing" standard of proof to protect particularly important individual interests in various civil cases. See, e.g., Woodby v. INS,, supra. at 285, 87 S.Ct, at 487 (deportation); Chaunt v. United States, 364 U.S. 350, 353, 81 S.Ct. 147, 149, 5 L.Ed.2d 120 (1960) (denaturalization); Schneiderman v. United States, 320 U.S. 118, 125, 159, 63 S.Ct. 1333, 1336, 1353, 87 L.Ed 1706 (1943) (denaturalization).
>
> Id., p. 424

C. Discharge - A Matter of Public Importance.

The drafters of our Constitution recognized the importance of the bankruptcy remedies for citizens when Congress was given

the power "to establish...uniform laws on the subject of bankruptcies throughout the United States." U.S. Constitution, Art. 1, Sec. 8, Cl. 4. It has long been recognized by this Court that providing a debtor with a fresh start in life is a main purpose of bankruptcy legislation:

> The federal system of bankruptcy...as a main purpose of the Act, intends to aid the unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character, after the property which he owned at the time of bankruptcy has been administered for the benefit of creditors.
>
> Stellwagen v. Clum, 245 U.S. 605, 617, 38 S.Ct. 215, 62 L.Ed 507 (1917).

It has also been observed by this Court that a discharge in bankruptcy is "a fundamental private necessity" as well as "a matter of great public concern." Local Loan Co. v. Hunt, 292 U.S. 234, 245, 54 S.Ct. 695, 78 L.Ed 1230 (1934). In passing its 1978 bankruptcy reform legislation, Congress reiterated the importance of providing a

debtor with a "fresh start" through the granting of a discharge:

> At the heart of the fresh start provisions of the bankruptcy law is Section 727 covering discharge. The discharge provisions **REQUIRE** the court to grant the debtor a discharge of **ALL** his debts except for very specific and serious infractions on his part.
>
> Pub. L. 95-598, 1978 U.S. Code Cong. & Admin. News, pp. 5793, 6340. (emphasis added).

D. Discharge - Liberty & Property.

In 1917, this Court recognized that the "fresh start" available to a debtor through bankruptcy was a liberty - "a new opportunity in life." Stellwagen, supra. p. 617. In 1934, this Court went further to recognize that the debtor's fresh start through discharge was a property right as well:

> The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right.
>
> Local Loan Co., supra., p. 245.

E. **Discharge - Exception v. Denial**

§ 523(a) of the Bankruptcy Act provides a method by which an individual creditor, "for very specific and serious infractions," can seek to have his debt survive the debtor's discharge. 11 U.S.C. § 523(a). That method still enables the debtor to obtain his fresh start, except for such debts that the bankruptcy judge may determine to be excepted under § 523. Those exceptions are commenced in the form of adversary proceedings involving one citizen against another -creditor against debtor. They are proceedings about a specific money obligation - not about the debtor's entire financial future.

To the contrary § 727(a) of the Bankruptcy Act sets forth certain circumstances pursuant to which a debtor would be deprived in toto of his discharge, and thereby - his "liberty" and his "property." 11 U.S.C. § 727(a).

Consequently, the stakes are greater in a denial of discharge case than in an exception to discharge case. In the exception to discharge case, the debtor is involved in a "typical civil case involving a monetary dispute between private parties." Addington, supra., p. 424. In a denial of discharge case, the debtor is fighting for his liberty and his property, matters of public importance requiring protection by the Courts. Local Loan Co., supra.

Congress, in its 1978 reform of the Bankruptcy Act, was aware of this distinction and observed that while the Bankruptcy law did permit denial of discharge in toto, misconduct may be better addressed by exception. Pub. L. 95-598, 1978 U.S. Code Cong. & Adm. News, p. 6089.

F. Denial of Discharge - Appropriate Standard of Proof.

Because a denial of discharge involves the deprivation of a debtor's

liberty and property, and because the granting of a discharge, and thereby a fresh start, involves a matter of important public interest, a stricter civil standard of proof should be required to afford due process of law to the debtor. Stellwagen, supra.; Local Loan Co., supra.; Addington, supra. In limiting its ruling in Grogan to exceptions to discharge, this Court surely must have considered that the dispute upon which it was ruling was "a monetary dispute between private parties" that did not affect the debtor's right to receive a discharge of his remaining debts. Grogan v. Garner, supra. "Preponderance of the evidence" was therefore held by this Court to be the appropriate standard of proof in an exception to discharge case. Id. This Court did not extend its ruling in Grogan to denials of discharge under § 727(a)(2).

In support of its ruling that "preponderance of the evidence" was the

appropriate standard for a § 523(a) exception, this Court did observe that Congress had mentioned that lower standard as appropriate for a § 727(a)(4) denial of discharge. Grogan v. Garner, supra. 498 U.S. 279, 289. No mention, however, was made in Grogan of Congressional comments disapproving of previous judicial attempts to lower the required standard of proof for certain exceptions:

> To the extent that Tinker v. Colwell, 139 (sic) U.S. 473 (1902) held that a less strict standard is intended, and to the extent that other cases have relied on Tinker to apply a "reckless disregard" standard, they are overruled.
>
> Pub. L. 95-598, 1978 U.S. Code Cong. & Admin. News, p. 5865.

Likewise, no mention was made in Grogan of comments in legislative history indicating that Congress did not intend to change the law as it applied to denials of discharge, and logically the standards of proof that were being followed at that time:

> Most concern misconduct by the debtor in the events leading up to bankruptcy and during the conduct of the case. These are left substantially intact, with one exception.
>
> Pub. L. 95-598, 1978 U.S. Code Cong. & Admin News, p. 6089.

That exception involved moving "false financial statements while engaged in business" from § 727 to § 523. Id.

While it may be argued that Congress intended to adopt "preponderance of the evidence" as the appropriate standard of proof for § 523(a) exceptions to discharge, a similar relaxing of the standard of proof for § 727(a)(2) denials of discharge, where a debtor's liberty and property could be deprived, would not be supported. This Court has already recognized that the Bankruptcy powers of Congress must still be subject to the protections of the Fifth Amendment. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 558, 55 S.Ct. 854, 863, 79 L.Ed 1593; motion denied, 55 S.Ct. 918; rehearing

denied, 56 S.Ct. 82 (1935). The Fifth Amendment expressly provides:

> No person shall...be deprived of life, liberty, or property, without due process of law,...
> U.S. Constitution, Amend. V.

Even though the revised Bankruptcy Act may have been silent regarding standards of proof for denials of discharge under § 727(a)(2), this Court has held that such silence should not be read as an intended departure from previous practice. Dewsnup v. Timm, 502 U.S. _____, 112 S.Ct. 773, 779, 116 L.Ed.2d 903 (1992); Butner v. United States, 440 U.S. 48, 54, 99 S.Ct. 914, 59 L.Ed.3d 136 (1979). Previous practice has seen courts require denials of discharge to be proved by "clear and convincing evidence," which practice has been clearly recommended in a widely recognized bankruptcy treatise:

> At the trial on a complaint objecting to discharge, the plaintiff has the burden of proving the objection. Some courts require that the plaintiff prove its case by "clear and convincing evidence."

> Others merely require proof by a "preponderance of the evidence." In view of the fresh start policy which favors the granting of the debtor's discharge, the stricter standard of proof seems appropriate.
>
> 4 Collier on Bankruptcy, §727.14 [6], p. 727-104.

G. Summary of Argument.

To deny a debtor his discharge is to deprive him of his liberty and property. A denial of discharge is in effect an "Economic Death Sentence." Following Addington guidelines, the appropriate standard of proof for § 727(a)(2) denial of discharge cases should therefore be "clear and convincing evidence," the standard in effect when Congress chose to leave the denial provisions of § 727 substantially intact. For the Court of Appeals to relax that standard of proof to permit a § 727(a) denial of discharge to be granted on only a "preponderance of the evidence," based on the authority of Grogan, is an unsupported leap that ignores this Court's precedents, that

denies due process to the Debtor, and that requires the exercise of this Court's power of supervision to resolve this federal question.

CONCLUSION

This Petition for Writ of Certiorari should therefore be granted, and the judgment of the Court of Appeals should be vacated. This Court should then determine that the applicable standard of proof for denials of discharge pursuant to 11 U.S.C. § 727(a)(2) is "clear and convincing evidence." Thereafter, this Court should either reverse the rulings of the lower courts, or remand this case for a new trial.

Respectfully submitted,

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APPENDIX A

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re:

ADAMS PLYWOOD, INC., Bk. No. 84 -23105
Debtor in Chapter 11

In re:

EDSEL AND FRANCES ADAMS, Bk. No. 84-23849
Debtors in Chapter 7,

BARCLAYS AMERICAN BUSINESS CREDIT, INC. Adv. No. 85-0357
Plaintiff,
v.

EDSEL AND FRANCES ADAMS,
Defendants.

RICHARD T. DOUGHTIE, III, Adv. No. 85-0814
Trustee,

v.

MARY ANGELA ADAMS and
BEVERLY ADAMS EAKER,
Defendants,

RICHARD T. DOUGHTIE, III, Adv. No. 85-0827
Trustee,

v.

MARY ANGELA ADAMS,
Defendant.

MEMORANDUM OPINION AND ORDER
(Filed June 18, 1986)

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Appearances: F. Guthrie Castle, Jr., Esq.
Herbert S. Falk, Jr., Esq.
Attorneys for Plaintiffs,

John D. Horne, Esq.,
Attorney for Defendants

At issue are whether the Trustee may avoid and recover, pursuant to 11 U.S.C. § 548, transfers of property made by Edsel and Frances Adams to their daughters within the year preceding their Chapter 7 filing and whether they should be denied a Chapter 7 discharge of their debts. The complaints in these proceedings are brought pursuant to 11 U.S.C. § 548(a), § 523(a)(2), § 523(a)(4), § 727(a)(2)(A), § 727(a)(3), § 727(a)4), § 727(a)(5), § 727(a)(6) and § 727(a)(7).

As indicated above, the primary parties involved in these proceedings are Frances and Edsel Adams, former principals of Adams Plywood, Inc., now Debtors in Chapter 7; their daughters, Angela Adams and Beverly Eaker; Adams Plywood's major creditor, Barclay's American Business Credit, Inc.; and the Trustee for the Chapter 7 estate, Richard

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T. Doughtie, III. The Court understands the present positions of the parties to be the result of the following facts.

In 1980, Edsel and Frances Adams became the proprietors of Adams Plywood in Abbeville, Alabama, which was later incorporated with Edsel being the 100% shareholder. They assumed operation of this plywood sales business from C & B Plywood, the successor to Great Northern Paper Company, which had been the successor to Mr. Tillis, Frances Adams' father. In 1982, Adams Plywood began manufacturing veneer and in the same year, Edsel Adams became the 45% shareholder in another plywood manufacturing concern known as West Memphis Plywood in West Memphis, Arkansas. On June 3, 1983, Mr. Adams and a Mr. Howard Meyer established a business for the marketing and distribution

of "shop grade"[1] plywood produced at the West Memphis and Adams Plywood companies. This business was named Magic City Plywood and Mr. Adams was the 51% owner.

Mr. Adams was contacted by a telemarketing representative from Barclays regarding financing for Adams Plywood in early 1983. Mr. Adams expressed an interest in obtaining such and the parties began negotiations toward that end. As was customary for Barclays, it conducted an audit of the inventory and records of Adams Plywood and West Memphis Plywood at a cost of $5,000.00 to Adams Plywood. Barclays was also given the personal financial statements of Edsel and Frances Adams. The result of these investigations was an agreement executed by the

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[1] It is the Court's understanding that the quality of plywood is classified by "grades." Top grade is the highest quality, e.g. it meets its purchaser's specifications; shop grade is lower quality which somehow does not meet specifications; blow grade is the lowest quality.

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parties on July 26, 1983. The agreement is evidenced by a master note (Tr.Ex. 18) and a general loan and security agreement (Tr.Ex. 116).

The essence of the agreement is as follows. Barclays would advance to Adams Plywood 50% of the value of its inventory and 85% of the value of its prime accounts receivable up to $3,000,000.00. The amounts to be advanced were determined monthly based upon the values reported to Barclays by Adams Plywood. In exchange, Barclays was given a $10,000.00 loan fee and granted a security interest in the inventory and accounts receivable as well as personal guarantees by Edsel and Frances Adams. Furthermore, in order that West Memphis' assets be a part of its collateral, Barclays agreed to advance funds to Mr. Adams for the payment of West Memphis' debt to Walter E. Heller & Co., Inc. Mr. Adams then loaned that amount to West Memphis and assigned his security interest in

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West Memphis' inventory and accounts receivable to Barclays. He also obtained control of 51% of West Memphis's stock shares, per an agreement with the co-owner, Mr. James McGowan, for the duration of the agreement with Barclays. Mr. Adams' "control" of West Memphis was important to Barclays because Mr. McGowan reportedly had a poor credit history (Tr.Ex. 200).

The mechanics of the loan agreement were that Adams Plywood would report monthly, via invoices, on the value of its accounts receivable. At the same time, it would report inventory valuations as would inventory auditors sent to Adams Plywood by Barclays. Based on these reports, Barclays would advance to Adams Plywood's operating account funds equalling 85% of the reported value of the accounts receivable and 50% of the value of the inventory. Meanwhile, Adams Plywood would collect the accounts receivable payments and deposit them in an account over

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which only Barclays had withdrawal authority. This account was known as the dominion account and was located at Union Planters National Bank. Adams Plywood's operating account was located at Southland Bank in Abbeville.

The accounts receivable advances were based upon the value of accounts receivable up to 60 days old. It should be noted here that Magic City accounts receivable were not eligible for such advances due to Mr. Adams' interest therein. It should also be noted that Mr. Adams testified that he was initially led to believe the accounts receivable advances would be made on receivables no more than 90 days old and the change to 60 days contributed to Adams Plywood's subsequent cash flow problems.

In the Fall of 1983, the property and buildings which house Adams Plywood became for sale and the Adamses began investigating arrangements for its purchase. In December,

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1983, Adams Plywood obtained a $250,000.00 loan from City of Abbeville Development Council and a $350,000.00 loan from Southland Bank for that purpose. The loan from Southland Bank was guaranteed by Mr. & Mrs. Adams.

At the same time, the Adamses were involved in attempting to sell West Memphis Plywood and consolidate all of their operations at the Abbeville location. The sale did not take place and operations ceased at West Memphis due to undercapitalization on or near December 15, 1983. The principals of West Memphis, the Adamses and McGowans, by corporate resolution (Tr.Ex.50), surrendered their lease to the holder, the First National Bank of Hot Springs, Arkansas, and arranged for the long term payout of some of West Memphis' vendors. It is the Court's understanding that other vendors were allowed to reclaim their merchandise. Leftover inventory was then moved to the Abbeville location

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and to storage facilities in Memphis and Birmingham. At or near this same time, Mr. Adams reported to Barclays that approximately $200,000.00-worth of inventory had been stolen from the West Memphis location. Barclays contends that that was the value of inventory returned to vendors.

Also, in early December of 1993, Mr. and Mrs. Adams began making arrangements to transfer property Mrs. Adams had acquired under her mother's will to their daughters. The property consisted of 6 acres and a house in Abbeville, Alabama. The transfers of that property to Beverly Eaker and Angela Adams, along with 510 shares of Magic City stock to Angela, were executed in late December, 1983 and early January, 1984. (Tr.Ex. 27-30). The Adamses testified that the transfers were made in accordance with the wishes and instructions of Mrs. Adams' parents. They were made in different years to avoid serious federal gift tax obligations and were record-

ed in the Registrar's Office of Henry County, Alabama. The recited consideration on the deeds is "$1.00 plus love and affection." The property was appraised for tax purposes at $100,000.00. Mr. Adams' 1984 gift tax return reflected that the value of the Magic City stock was $2,386.00. (Tr.Ex. 172). However, Mr. Adams testified that the accountant who prepared the return had mistakenly listed the value of all of the outstanding shares of Magic City stock and that the correct value of those transferred to Angela was $1,216.99. Angela subsequently, in November of 1984, sold the stock to Howard Meyer for $12,000.00. These are the transfers the Trustee seeks to avoid pursuant to 11 U.S.C. § 548(a).

At the time these transfers were made, according to the Adamses' testimony, they believed Adams Plywood to have a net worth of $352,508.95. This was based on an inventory valuation of $1,387,000.00. A January 28,

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1984 balance sheet reflects Adams Plywood's total assets to have been $3,214,815.76 while its debts totalled $2,838,356.99 inclusive of $1,173,144.54 owed to Barclays. (Tr.Ex.174). The reported gross sales for the year ending December 1, 1983 were $4,893,000.00. Moreover, the Adamses claim to have had substantial equity in their home and other real estate.

In fact, according to the Adamses, Adams Plywood did not begin experiencing financial difficulty until the Spring of 1984 when it received a low credit rating from the Lumberman's Credit Association, Inc. (Tr.Ex. 42). This rating was based upon reports from suppliers of Adams Plywood that the company was "slow" to "very slow" in paying them. This, the Adamses contend, was a result of the problems encountered in paying off the suppliers to the West Memphis plant. In order to aid the situation somewhat, Mrs.

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Adams then loaned Adams Plywood $15,000.00 of her own funds.

During this time, according to its Vice-President, Michael Faircloth, and various correspondence and memoranda, Barclays was concerned that Adams Plywood was not selling more of its inventory and providing them with timely reports. (Tr.Ex. 209, 203 and 210). As early as March 1, 1984, Barclays began suggesting that Adams Plywood consider locating another financier for its operations. Barclays ultimately came to believe, based upon the slow rate at which inventory was sold, the amount of customer credits due to defective merchandise sold, and the high percentage of accounts receivable due from Magic City, that the inventory had been overvalued.

At a meeting on March 26, 1984 between Mr. Faircloth, Mr. Adams and Mr. Barry Johnson (Adams Plywood's then loan officer at Barclays), Mr. Adams explained that the

problems stemmed from the sale by Adams of, previously unknown to him, defective goods manufactured by the West Memphis plant. (Tr.Ex. 210). He agreed to implement a quality control plan at Adams Plywood and was subsequently allowed a $68,000.00 over-advance without prior approval in late of June 1984. The over-advance was approved by Adams Plywood's then loan officer, Roger Attix, due to "updated inventory numbers." It was to be cleared at a rate of $2,000.00 per day. (Tr.Ex. 64). Furthermore, despite Barclays' concern over the inventory, its own auditor reported in a June 7, 1884 memo that the finished goods inventory was in "excellent condition." (Tr.Ex. 63).

Meanwhile, at the urging of Barclays, the Adamses began investigating alternative means of financing for the plant and contacted several financiers. Among them were Fleet Credit Corporation, Allegheny International Credit Corporation, and the Walter E. Heller

Co. Although Adams Plywood went so far as to receive a commitment letter subject to an audit result from Fleet Credit Corp. and pay them $5,000.00 for such an audit, no alternative financing was secured. (Tr.Ex. 43).

Adams Plywood continued having cash flow problems throughout the Summer of 1984 and Barclays notified them that it would insist on a plan of orderly liquidation beginning September 1, 1984 if the situation did not improve. Adams Plywood then filed a Chapter 11 Petition with this Court on August 22, 1984.

Subsequent to the Chapter 11 filing, Barclays in an August 29, 1984 letter from its counsel, Mr. Herbert Falk, notified Mr. and Mrs. Adams that they as guarantors of Adams Plywood's obligation to Barclays had five days within which to pay the sum demanded, to wit: $1,121,354.05 plus interest. (Tr.Ex. 44). The payment demanded was not made and on September 21, 1984 Barclays filed

suit in the Federal District Court for the Middle District of North Carolina against the Adamses for the amounts due. (Tr.Ex. 45). On October 9, 1984, the Adamses filed a Chapter 7 Petition in this Court.

Following the filing of the Bankruptcy petitions, Barclays began conducting a rather detailed audit of all three debtors' books and records through one of its portfolio managers, Mr. Mike Johnson, C.P.A. According to his testimony and documentary evidence, he discovered the following:

1) As early as November of 1983 Adams Plywood was depositing collections on its accounts receivables from Magic City into its operating account (although Magic City accounts receivables were not eligible for advance purposes their proceeds were considered collateral); this continued until August 17, 1984. (Tr.Ex. 78).

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2) On or near July 16, 1984, Adams Plywood began depositing collections on all of its accounts receivable into its operating account at Southland Bank and later remitting some of the funds from that account to Barclays dominion account. (Tr.Ex. 78 and 54).

3) On August 21, 1984, a $15,534.35 check payable to Adams Plywood from Magic City was cashed at Southland Bank and the proceeds unaccounted for. (Tr.Ex. 78, check no. 743).

4) On August 24, 1984, two days after the Chapter 11 filing, a checking account was opened at Commerce Union Bank in Memphis, Tennessee with $99,378.42 transferred from Adams Plywood's operating account at Southland. (Tr.Ex. 54 and 93).

5) Between August 24 and September 5, 1984 approximately $49,514.32 was paid out of the Commerce Union account by

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wire transfers and checks dated August 24 to August 29, 1984. Of this amount $17,100.00 was transferred to Adams Plywood's Southern bank account, $26,019.58 was transferred to Cahaba-Abbeville;[2] the remainder consisted of telephone, American Express, and insurance payments.

Consequently, on September 6, 1984, Barclays obtained an interim order from this Court prohibiting further unauthorized disbursements from the Commerce Union account. (Tr.Ex. 90). Barclays subsequently agreed to the use by Mr. Adams of $21,800.00 for the effectuation of an orderly liquidation of Adams Plywood's assets. The Adamses testified that at this time they had been informed by their attorney that no allowed post petition use of cash collateral would be forth-

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[2] Cahaba-Abbeville was Adams Plywood's supplier of veneer and operated at the same facility as Adams. The relationship of the two will be discussed subsequently.

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coming from Barclays and they decided not to reorganize the company. According to Mr. Mike Johnson, $62,354.31 was disbursed from the Commerce Union (debtor-in-possession) account without authorization from Barclays. Moreover, the dominion account was approximately $150,000.00 "short" when the Chapter 11 was filed.

The Adamses testified as follows regarding the above events.

1) According to Mr. Adams, Mike Johnson conducted an audit of Adams Plywood's affairs in the Fall of 1983. At that time, Magic City's accounts were classified as "intercompany accounts" that were ineligible for accounts receivable advances. Consequently, Mr. Adams believed the transfers from Magic City to Adams Plywood to be "intercompany transfers" and treated them as such.

2) With regard to the deposits of collected accounts receivable into

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Adams' operating account during July and August, 1984, the Adamses claimed that this procedure was initiated and authorized by their loan officer, Mr. Attix, after two collected checks "bounced" after being deposited into the dominion account. The $150,000.00 deficit was due to the Adamses' expectation of approval of an overadvance in that amount from Barclays. Mr. Attix testified that he never approved the deposits into Adams' operating account. He also denied discussing any overadvance other than the one for $68,000.00 in June with the Adamses. It should be noted that an overadvance request of $20,000.00 from Adams Plywood was documented by Barclays in August, 1984, however, Mr. Attix testified that he never discussed that with the Adamses either. (Tr.Ex. 65).

3) The $15,534.35 Magic City check cashed on August 21, 1984 was used to pay the Adamses' attorneys; the $17,000.00 was used to "make the payroll" at Adams Plywood. The $26,019.58 paid to Cahaba, postpetition, was for the purchase of raw materials needed to keep Adams Plywood in operation.

4) Finally, as to the postpetition transfer of $99,378.42 from Adams' operating account to Commerce Union Bank account, Mr. Adams testified that he did not remit that amount to Barclays because he understood that it was to be used for the operation and reorganization of the plant.

Turning to the Cahaba-Abbeville issue mentioned above, Barclays alleges that Mr. Adams was the owner or that they were led to believe that he was and relied on its inventory as collateral. Cahaba had its operations at the same facility as Adams Plywood

and was Adams' supplier of veneer. Several of Cahaba's administrative employees were the same as Adams Plywood's. In April of 1984, Mr. Adams paid Cahaba some $15,000.00 which Barclays alleges was for the purchase of the Cahaba company. Mr. Adams, Mr. Stewart Fuzzell, Jr. (via deposition), one of Cahaba's principals, and Mr. Charles Woodham (via deposition), closing attorney for the proposed sale, testified that the sale was never consummated. Mr. Adams claimed that the $15,000.00 payment was due the shareholders of Cahaba for taxes paid and goods purchased by Adams Plywood. Mr. Fuzzell testified (depo. p. 71, L. 22) that the sale was never closed because he "never got paid." Mr. Woodham testified (depo. p. 23, L. 10) that the sale did not close because the sellers did not provide the "necessary documentation."

Barclays' additional investigations further revealed that on August 28, 1984,

Mrs. Adams cashed a check with funds from the Adamses' personal account at First Tennessee Bank for $12,000.00. (Tr.Ex. 1). She obtained three $4,000.00 cashier's checks. (Tr.Ex. 2, 7, & 8). On September 13, 1984 she opened a checking account in her maiden name of Frances L. Tillis at AmSouth Bank in Birmingham, Alabama with her husband's pay-checks. The beginning balance was $4,404.50. (Tr.Ex. 9 & 10). On September 17, 1984, she endorsed and deposited one of the cashier's checks into the Adamses' First Tennessee account. (Tr.Ex. 2 & 3). On the third of October, 1984, she endorsed and cashed the remaining cashier's checks. (Tr.Ex. 7 & 8). On October 5, 1984, a $4,000.00 check drawn on the Adamses' personal account was paid to their attorney, Mr. Phillip Shanks, III, and a $1,000.00 check was cashed. (Tr.Ex. 5 & 6).

At the hearing, Mrs. Adams explained that she had cashed the $12,000.00 check in order to have the means necessary for her

family's "living expenses." She further testified that she was "frightened and confused" by the bankruptcy filing of Adams Plywood, Mr. Falk's guaranty demand letter, and an additional ongoing lawsuit against Adams Plywood by American Hardwood and that she felt her family would need and, in fact did need, the money for its expenses. With reference to the "Tillis account." Mrs. Adams claimed to have opened it as a means of protection for herself because she and Mr. Adams were experiencing marital difficulties at the time. As to the check to Mr. Shanks, Mrs. Adams explained that it was payment for the services of filing Adams Plywood's Bankruptcy Petition and representing Adams Plywood in additional matters. The $1,000.00 check was cashed to "cover the expenses" of their Chapter 7 filing on October 9, 1984.

The Adamses, through their attorney, Mr. Shanks, filed their "Schedule of Affairs" with this Court on November 20, 1984. (Tr.Ex.

119). Presented at the hearing by Barclays as significant are the following questions (in pertinent part) and answers from this schedule.

1.b. Have you used... any other names within the six years preceding the filing...?

Husband: No Wife: No answer

2.e. What amount of income have you received from other sources [than salary] during ... [the] two years [preceding the filing]?

None

3.b. What tax refunds ... have you received during the year ... preceding the filing...?

None

4.a. What accounts or certificates of deposit or shares in banks [etc.] ... have you maintained, ... in your own or any other name within the two years ... preceding the filing of the petition...?

Husband: Bank checking account - First Tennessee Bank

Wife: Same

12.a. Have you made any gifts, other than ordinary, usual presents to family members ... during the year ... preceding the filing...?

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Husband: No Wife: No

15.b. Have you during the year ... preceding or since the filing ... agreed to pay any money ... to an attorney-at-law...?

Husband: Yes, $440.00 plus $60.00 filing fee

Wife: Yes, $440.00 plus $60.00 filing fee

According to Barclays, these items are significant in that Mrs. Adams used her maiden name to open the checking account at AmSouth, the Adamses received rental income in the year preceding the filing from property leased in Alabama, they also received an income tax refund in the year preceding the filing, and one or both of them had certificates of deposits along with the Tillis bank account at the time of or in the two years preceding the filing. In addition, they gave the house and six acres along with Magic City stock to their daughters in the year preceding the filing, and paid their attorney a known $4,000.00.

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According to the Adamses, the Schedule of Affairs, as filed, was completed by their attorney based primarily on phone conversations with him which did not provide them with a full understanding of the questions. The evidence reflects that the Adamses did not sign the schedules before they were filed and in fact did not see them until their First Meeting of Creditors on January 15, 1985. Moreover, the Adamses testified that they later supplied the missing information.

The information later supplied, according to Barclays, was only supplied after repeated attempts by them to obtain it through discovery depositions and subpoenas. This is the basis for their allegation that the Adamses attempted to conceal pertinent information after their petition was filed. According to the Adamses, they turned over to Barclays the books and records that were in their possession at the time of Barclays's requests but that many were taken by the IRS

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which was conducting an audit of same during the pendency of the petitions.

It is the Adamses' contention that they did not intend nor would have needed to remain in a Chapter 7 had Barclays conducted a commercially reasonable sale of the Adams Plywood assets. They anticipated that the proceeds from the sale of the inventory and collections of accounts receivable would more than satisfy Barclays's claim. Furthermore, they agreed to abandon the inventory to Barclays (Tr.Ex. 80) in exchange for a minimum $250,000.00 credit on their debt to Barclays because they were positive that Mr. Adams would have "veto power" over any proposed sale and that sale of the inventory would bring more than that amount. As it happened, Mr. Adams was not allowed to participate in the sale and such was conducted by an auction of the inventory after foreclosure by Barclays. For this reason, the inventory brought far less than its value in

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Mr. Adams' estimation. In essence, according to Mr. Adams, even if the auction were a commercially reasonable auction, (which he contends it was not) less was realized for the inventory than would have been at a private sale.

Of course, Barclays contends that the inventory was mostly "shop grade" plywood that was worth less than Mr. Adams' valuation and brought as much as practicable at the auction. The auctioneer, Mr. Gene Motes, provided testimonial and documentary evidence to the effect that the auction was conducted in a customary manner and that all that could have been done to publicize the sale and generate interest therein was done.

It is Barclays contention that the Adamses are to blame for any deficiency resulting from the inventory's sale and receivables collected in that they knowingly overvalued the inventory. It is also

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Barclays position that the events discussed above reflect a series of fraudulent dealings which should serve to prevent the Adamses from receiving a discharge of their debts. The amount owed Barclays as of April 16, 1986 was $808,499.21. (Tr.Ex. 211).

The first event of which Barclays complains is that of the transfer of the house and six acres and Magic City stock shares to the Adamses' daughters. Barclays and the Trustee contend that these transfers are of the type described by 11 U.S.C. § 548(a) and § 727(a)(2)(A). As such they seek a money judgment (rather than avoidance of the transfers) in the amount of $112,000.00. § 548(a) provides in pertinent part:

> The trustee may avoid any transfer of an interest of the debtor in property, ... that was made on or within one year before ... the filing of the petition, if the debtor voluntarily or involuntarily -
>
> (1) Made such transfer ... with actual intent to hinder, delay, or defraud any entity to which the debtor was or became

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on or after the date that such transfer was made ..., indebted; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer ..., and

(B)(i) was insolvent on the date that such transfer was made ..., or became insolvent as a result of such transfer ...,

(ii) was engaged in a business or transaction, or was about to engage in a business or transaction for which any property remaining with the debtor was an unreasonably small capital; or

(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

In pertinent part, § 727(a)(2)(A) provides;

(a) The court shall grant the debtor a discharge, unless ...

(2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be [such] -

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(A) property of the debtor, within one year before the date of the filing of the petition;

(B) property of the estate, after the date of the filing of the petition; ...

It is clear from the statutory language that §§ 548(a)(1) and 727(a)(2)(A) require a showing of actual intent by the debtor to hinder, delay, or defraud creditors in order to avoid a transfer or bar a discharge. In re: Marcus, 45 Bankr. 338 (D.C.S.D. N.Y. 1984). In addition, the cases reflect that where an objection to discharge is involved, the statutes are to be construed liberally in favor of the debtor and strictly against the objecting party. See, e.g., In re: Hayes, 31 Bankr. 285 (Bankr. E.D. Tenn. 1983). In re: Gordley, 38 Bankr. 630 (Bankr. S.D. Ohio 1983). However, while actual intent as opposed to constructive intent must be shown, the cases also indicate that such may be inferred from the debtor's actions and circumstances surrounding the transfer. More-

over, because the statutory language is in the disjunctive, intent to hinder or delay a creditor is sufficient to void a transfer or bar discharge and transfers to family members are to be closely scrutinized. In re: Gordley, supra.; In re: Cycle Accounting Services, 43 Bankr. 264 (Bankr. E.D. Tenn. 1984).

Barclays contends that the Adamses possessed actual intent to hinder, delay, or defraud their creditors by these transfers. As support for its contention it advances the following. The real property transferred was listed as an asset on the financial statement given to Barclays as inducement for its loan. (Tr.Ex. 16). This real property and stock was the only unencumbered property owned by the Adamses and it was transferred for inadequate consideration to family members. At the time of the transfer, the Adamses were experiencing extreme financial difficulty due to the closing of West Memphis Plywood and

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pressure from Barclays "to move" inventory and knew that their inventory was below "top" or "on" grade quality. Finally, the Adamses failed to disclose the transfer on their bankruptcy schedules.

The Adamses deny that the real property was among the assets listed as inducement for Barclays's loan. According to their testimony, the financial statement which includes this property was not the one presented to Barclays because it was not signed. (Tr.Ex. 16). Furthermore, they claim to have consulted a banker regarding their April 1983 financial statement and were advised to omit that property from their asset listing as it was still in probate. Therefore, they claim that the statement including the property and submitted by Barclays was one removed from their files by Barclays' representatives rather than the one they gave Barclays. In support of this claim, the Adamses submitted trial exhibit 169; a financial statement,

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minus the property in question, dated April 30, 1983, and signed by Mr. Adams.

The Adamses do not deny that this was their only unencumbered property, nor that it was transferred to family members for little or no consideration. However, they do deny that they were experiencing extreme financial pressure at the time of the transfer, citing the 1983 gross sales of $4,893,000.00 at Adams Plywood, their belief in the $352,508.95 net value of Adams Plywood, and their other assets, e.g. their home in Memphis, Tennessee. According to the Adamses, despite the problems with West Memphis, they believed that Adams Plywood was financially strong enough to alleviate the problems by sales of its products. Their belief in the value of their company's inventory was reinforced by Barclays' inventory auditors.

As discussed above, they deny having any financial problems personally or at Adams

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Plywood until the Spring of 1984 when the company received an unfavorable credit rating from the Lumberman's Credit Association and suggestions from Barclays that finding another financier might become necessary.

With regard to the omission of this transfer from their bankruptcy schedule, Mr. Adams testified that the information on the schedules was partially given to his attorney "over the phone" and "in writing." Both Mr. and Mrs. Adams testified that neither saw nor signed the schedules prior to their being filed with the court and that any omissions or incorrect information was the result of misunderstanding and miscommunication between themselves and their former attorney. The attorney did not testify.

Finally, as discussed above, the Adamses content that the making of these transfers was to comply with the wishes of Mrs. Adams' mother. The when and how of the transfers constituted the implementation of estate

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planning as suggested to them by one in the field in order to avoid the necessity of paying large gift or future estate taxes on the transfer of the property to their daughters.

Being cognizant of the close scrutiny applied to transactions where, as here, property is transferred to family members for little or no consideration within the year preceding a bankruptcy filing, the Court in this situation is impressed by the following. The Adamses' financial statement that includes the real property is unsigned; both Mr. and Mrs. Adams were adamant about the fact that only signed statements were delivered to any creditor for its consideration. In reference to the West Memphis situation, in one of its own early (July, 1983) investigation reports, a Barclays representative reported that the co-owner, Mr. McGowan, had had severe financial problems which reflected on the company and as a result Mr. Adams

should be placed in control. (Tr.Ex. 200). This is in keeping with the Adamses' testimony that they believed the December, 1983 problems there would be overcome by consolidation of the businesses under the control of Mr. Adams and that the inventory possessed a high value. With regard to the inventory valuations, despite Barclays' assertion that the inventory was intentionally over valued at the time of the transfer, its own inventory auditors as late as June, 1984 reported favorably on its value. As to Mr. Adams' opinion of the inventory's value, he has testified that he believed until the time of the auction that it would "bring enough" to satisfy the debt to Barclays. He continues to content that had the sale been properly conducted, it would have.

Upon careful consideration of the circumstances surrounding this transfer, it does not appear to have been conclusively shown that the Adamses possessed the actual intent

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to hinder, delay, or defraud their creditors by this transfer necessary to avoid same or bar their discharges. Therefore, the question becomes whether they were insolvent or were rendered such by the transfer at the time it was made. This the second test under § 548(a).

As set forth above, a transfer made in the year preceding a bankruptcy filing for which a debtor "received less than a reasonably equivalent value in exchange, and" made when the debtor was insolvent or was rendered such may be avoided by the trustee. 11 U.S.C. § 548(a)(2)(A). It is evident that the intent to delay, hinder, or defraud creditors need not be shown in order to avoid a transfer pursuant to this section. Given that the first part of the statutory requirement is present here, i.e. that the transfer was made for "less than a reasonably equivalent value," the Court must determine whether the Adamses were insolvent or were made such

by the transfer. The Bankruptcy Code employs the "balance sheet" test for determining whether a debtor was insolvent at the time of or became such as the result of a pre-petition transfer. This test requires that;

> ... the sum of [the] entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of -
>
> (i) property transferred, concealed, or removed with intent to hinder, delay, or defraud ... creditors; and
>
> (ii) property that may be exempted from property of the estate ...

11 U.S.C. § 101(29)(A); see also, In re: Willis, 48 Bankr. 295 (D.C.S.D. Tex. 1985), In re: Porter, 37 Bankr. 56 (Bankr. E.D. V.A. 1984).

As discussed above, at the time of the transfers in December, 1983 and January, 1984, the Adamses contend that the net value of Adams Plywood was $352,508.95 based upon an inventory valuation of $1,387,000.00. The

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inventory valuation was based upon cost according to Mr. Adams. In addition, the Adamses claim to have had real property valued at $301,550.00, excluding the $100,000.00 property transferred, along with approximately $40,000.00 in personalty. Thus, from these figures, their total assets had an approximate value of $694,059.00. At the same time, they were indebted to Southland Bank for approximately $85,000.00 which was secured by 441 acres of farmland valued at $165,550.00; to First Tennessee Bank for $40,000.00 which was secured by their residence valued at $120,000.00; to Southland Bank for an additional $55,000.00 also secured by their residence; and to Union Planters National Bank (after December 29, 1983) for $20,000.00 secured by Mrs. Adams' automobile. In addition, they were the guarantors, on behalf of Adams Plywood, of a $350,000.00 obligation to Southland Bank that they assumed on December 7, 1983 for the

purchase of the plant facilities along with the approximate $1,500,000.00 then owed to Barclays by Adams Plywood. Adams Plywood was indebted to the City of Abbeville Development Council for $250,000.00, also borrowed to purchase the facilities.

Mr. Adams testified that the Adams Plywood debts to Barclays and Southland Bank were primarily corporate obligations and as such he had included them along with the "corporate only" debt to the Development Council in calculating the company's net worth. Mr. Adams' stated method of calculating these liabilities is supported by Adams Plywood's January, 1984 balance sheet which reflects an indebtedness of $2,838,356.99 and assets, including inventory, of $3,214,815.76 (Tr.Ex. 174).

In summary, according to the Adamses' calculations they had strictly personal liabilities of approximately $200,000.00 at the time of the transfers even though their

potential liability was over $2,000,000.00. As such, their personal net worth was approximately $500,000.00 exclusive of the property transferred.

As to these figures, it is Barclays' position that the inventory was worth far less than reported by the Adamses. This, claims Barclays, is evidenced by the $184,200.00 for which the inventory sold at auction on April 2, 1985. Consequently, Barclays contends that the Adamses were liable for the corporate debts they guaranteed were thus insolvent at the time of the transfers.

It is clear to the Court that the inventory when auctioned brought much less than anticipated and that at least part of the reason was that a good portion of the inventory auctioned was not "top grade." However, it is not clear that the inventory on hand at Adams Plywood in August of 1984 when the Chapter 11 petition was filed and subsequent-

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ly auctioned was the same inventory on hand in December of 1983 and January of 1984 despite the allegations that inventory was not being sold quickly during the relevant time period. There is also evidence that some of the inventory was removed from the plant and sold illegally post-petition by one purporting to be an agent of Barclays. Therefore, taking the evidence in the light most favorable to the debtors, the Court concludes that they were not insolvent at the time of the transfers nor were they rendered such thereby. In re: Porter, supra.

The Court will next consider the proposition that the Adamses should be denied a Chapter 7 discharge of their debts because they engaged in a scheme designed to hinder, delay, or defraud their creditors and undermine the purposes and policies of the Bankruptcy Code. While it is well settled that the discharge provisions of the Code are to be construed liberally in favor of the

debtor, it is equally well settled that the discharge provisions were meant to relieve the honest debtor from his debts and those who have attempted to violate these provisions should not be allowed to benefit from them. In re: Esposito, 44 Bankr. 817 (Bankr. S.D. N.Y. 1984). Moreover, the Court is mindful that, according to the language of 11 U.S.C. § 727(a)(2), (quoted above) a finding of either intent to hinder, delay, or defraud a creditor is sufficient to deny discharge. In re: Cycle Accounting Services, supra. In regard to the alleged § 727(a)(2) violations, the Court has before it the following facts and circumstances.

The deposits of accounts receivable collections into Adams Plywood's operating account rather than Barclays' dominion account; the failure of the Adamses to subsequently remit same in full to the dominion account; and the resulting $150,000.00 deficiency in the dominion account at the time of

the Chapter 11 filing. The post-petition transfer of $99,378.42 from the Chapter 11 debtor's operating account into a new account. The unauthorized disbursement of $62,354.31 from that account by the Adamses and the attainment by Mrs. Adams of $12,000.00 for anticipated living expenses along with the use of approximately $4,000.00 by her to open a checking account in her maiden name.

As mentioned above, the Adamses offered the following explanations for these events. They understood that it was necessary to deposit the collections into Adams Plywood's account in order to avoid the deposit of insufficiently funded checks into the dominion account as had occurred once or twice in early July. They withheld funds from the dominion account because they believed they would receive an over advance allowance of $150,000.00 in early August. They testified that Mr. Attix had told them this and pre-

sented the Court with an August 13, 1984 letter from Mr. Adams to Mr. Attix expressing his appreciation for such. (Tr.Ex. 77). The $99,378.42 was transferred out of Adams Plywood's account and not remitted to Barclays because Mr. Adams believed such had been authorized as necessary to carry on operations at the plant. The unauthorized disbursements were reportedly used for that purpose and later to cover the expenses incurred by Mr. Adams in attempting to liquidate the business.

Mrs. Adams testified that she took the $12,000.00 to cover expenses for herself and her family. She reportedly opened the Tillis account to provide herself with resources as she and Mr. Adams were experiencing marital difficulties and she was "frightened by the occurrences connected with Adams Plywood's bankruptcy."

Mr. Attix testified that although there had been a problem or two with the deposits

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of insufficiently funded checks into the dominion account, he had not authorized deposits into the operating account. Mr. Faircloth, Barclays' Vice-President, testified that as a matter of company policy, such a procedure would never have been authorized. Mr. Johnson, Barclays' auditor, expressed surprise at discovering the "diverted" deposits. In addition, Barclays provided the Court with a copy of a January, 1984 letter from Mrs. Adams to Union Planters National Bank (the location of the operating account) authorizing the bank to debit the operating account for any service charges incurred by the dominion account. (Tr.Ex. 190).

With respect to the "held out" funds and the Adamses expectation of an over advance, Mr. Attix testified that an "after the fact" approval for the $68,000.00 had in fact been given to the Adamses in June, 1984. However, three officials of Barclays, including Mr. Attix, testified that no request for a

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$150,000.00 over advance was made or approved. Moreover, no documentation by Barclays of such request was presented to the Court, as was the case with the other requests discussed above, and Mr. Attix along with the other officials denied receipt of Mr. Adams' letter of August 13, 1984. According to Mr. Faircloth, Mr. Johnson, and Mr. Attix an over advance request of that size would have had to go through several "channels" at Barclays before being approved. A loan officer could not singularly approve such.

As to the post-petition transfers and disbursements, Barclays contends that no authorization for the initial ones was granted as evidenced by its attainment of a temporary restraining order from this Court prohibiting such on September 6, 1984. Subsequent authorization was granted for the use by Mr. Adams of $21,800.00 to conduct private sales of Adams Plywood's inventory. Accord-

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ing to Barclays, $62,354.31 was used post-petition without authorization.

From the above facts and circumstances, the Court draws the following conclusions. The explanations of the Adamses for their depositing collected funds into the operating account and failing to remit same to Barclays' dominion account are reasonable. However, the separate testimonies of the Barclays' officials does much to discredit them. Moreover, except for the August 13, 1984 letter written by Mr. Adams regarding the over advance and reportedly unreceived by Barclays, there is no documentary evidence to support the Adamses' explanations. This factor is significant to the Court because of the over 200 exhibits submitted in the cause, numerous ones were documented accounts of contacts with the Adamses by Barclays' representatives. In fact there appears to be a documented account of every meeting had with the Adamses and pertinent to these proceed-

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ings which leads the Court to conclude that such documentation was a customary if not required practice in the day to day business conducted by Barclays' personnel. Therefore, in light of the nearly eighteen months of discovery conducted in reference to these proceedings, it appears likely that if Barclays had authorized such activities, the decision, first would have been documented, and secondly, would have been discovered and produced at trial.

Consequently, even though the Adamses' belief that they would be granted an over advance is reasonable, particularly given that they had previously obtained one for $68,000.00 without prior approval, there is simply no evidence to support their contention that they actually requested an over advance or received approval for such.

There is an equal lack of supporting evidence for the Adamses' contention that the

transfer of $99,378.42 from Adams Plywood to a personal account and disbursement of $49,514.32 of that amount in the two weeks following the filing of Adams Plywood's bankruptcy petition was authorized. To the contrary, it appears most evident that these transfers were not authorized in light of Barclays' request for an attainment of a temporary restraining order prohibiting such on September 6, 1984.

With respect to the funds obtained by Mrs. Adams post-petition, they were admittedly obtained for the personal use of the Adamses. Moreover, they constituted funds which would have been property of Adams Plywood's bankruptcy estate pursuant to § 541(a).

The Court is cognizant of the fact that financial difficulties which culminate in the filing of a bankruptcy petition are most troublesome for the individuals involved and may cause those individuals to engage in

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daring efforts to salvage their properties and businesses. It is equally aware that it is extremely difficult to find fault with an individual's "belief" or "understanding" regarding any given set of circumstances. However, in the case at bar, the evidence is overwhelming that the Adamses caused to be made pre and post petition transfers of property which was subject to the validly perfected security interest of Barclays. Moreover, the pre-petition transfers were made in the wake of Barclays' admonition that it would require an orderly liquidation of Adams Plywood's inventory if sales did not improve by September 1, 1984.

As indicated above, in order to bar a debtor's discharge pursuant to 11 U.S.C. § 727(a), it is necessary that the objecting party conclusively show that the debtor actually intended to hinder, delay, or defraud his creditors. See In re: Cycle Accounting Services, Inc., supra. In re: Porter, supra.

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Given the above facts and circumstances, the Court must conclude that Barclays has met the burden of conclusively showing that the Adamses actually intended to hinder or delay the collection of its debt by these pre and post-petition transfers.

Having made this determination, it is unnecessary for the Court to consider the additional objections of Barclays pursuant to 11 U.S.C. § 523 and other subsections of 11 U.S.C. § 727.

IT IS THEREFORE, HEREBY ORDERED THAT:

1) the complaint of the trustee seeking to avoid the transfers of property made by the Debtors to their daughters in the year preceding the filing of their Chapter 7 petition is denied;

2) the complaint of Barclays seeking to deny the Debtors' discharge pursuant to 11 U.S.C. § 727(a)(2)(A) & (B) is granted.

ENTERED this 18th date of June, 1986.

/s/ WILLIAM B. LEFFLER
UNITED STATES BANKRUPTCY JUDGE

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APPENDIX B

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

EDSEL AND FRANCES T. ADAMS,
Debtors,

Bk. No. 84-23849-L
Chapter 7, (Asset)

BARCLAYS AMERICAN
BUSINESS CREDIT, INC.
Plaintiff,
v.

Adv. No. 85-0357

EDSEL AND FRANCES T. ADAMS,
Defendants.

JUDGMENT ON DECISION BY THE COURT
(Filed June 27, 1986)

This proceeding having come on for trial or hearing before the court, Honorable WILLIAM B. LEFFLER, United States Bankruptcy Judge, presiding, and the issues having been duly tried or heard and a decision having been rendered,

IT IS ORDERED AND ADJUDGED

In accordance with "Judgment" for $731,367.74 + interest, entered June 27, 1986, judgment is hereby entered.

/s/ WILLIAM B. LEFFLER
U.S. BANKRUPTCY JUDGE

Date of issuance:
June 27, 1986

/s/ GEORGE W. EMERSON, JR.
Clerk of Bankruptcy Court

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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

IN RE:

EDSEL ADAMS AND
FRANCES T. ADAMS,

No. 84-23849-L
Chapter 7

Debtors

* * * * * * * * * * *

BARCLAYS/AMERICAN BUSINESS
CREDIT, INC.

Plaintiff,

v.

Adv. Proceeding
No. 85-0357

EDSEL ADAMS and
FRANCES T. ADAMS,

Defendants.

JUDGMENT
(Filed June 27, 1986)

This cause came to be heard on April 21, 1986, and was tried thereafter from day to day until closing on May 2, 1986. From all the proof heard and in accordance with this Court's Memorandum Opinion and Order issued on June 18, 1986, denying Debtors' discharge pursuant to 11 U.S.C. § 727(a)(2)(A) & (B), judgment is accordingly granted as follows:

1. Debtors are hereby denied discharge in their Chapter 7 case;

2. Barclays/American Business Credit, Inc., shall have a judgment against the Debtors, jointly and severally, in the amount of $731,367.74 plus interest at the judgment rate to run from date of entry hereof; and

3. The costs of this adversary proceeding are assessed against the Debtors;

for all of which execute may issue.

Signed this 27th day of June, 1986.

/s/ WILLIAM B. LEFFLER
U.S. BANKRUPTCY JUDGE

Submitted by:

BOROD & HUGGINS
P.O. Box 3783
Memphis, Tennessee 38173
(901)526-7000
By: /s/ F. Guthrie Castle, Jr.

FALK, CARRUTHERS & ROTH, P.A.
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By: /s/ Herbert S. Falk, Jr.

ATTORNEYS FOR BARCLAYS/AMERICAN BUSINESS CREDIT, INC.

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APPENDIX C

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

IN RE:

EDSEL ADAMS AND
FRANCES T. ADAMS,

Case No.
84-23849-L

Debtors in Chapter 7

* * * * * * * * * * * *

BARCLAYS/AMERICAN BUSINESS
CREDIT, INC.

Plaintiff,

v.

Adversary Proceeding
No. 85-0357

EDSEL ADAMS and
FRANCES T. ADAMS,

Defendants.

ORDER DENYING MOTION OF DEFENDANT-DEBTORS
TO REOPEN CASE, FOR NEW TRIAL
AND TO DISQUALIFY JUDGE
(Filed January 10, 1992 nunc pro tunc)

This cause came on to be heard upon the Motion of the Defendant-Debtors to reopen the adversary proceeding in which their discharges were denied and in which the Plaintiff was awarded a non-dischargeable judgment against the Defendant-Debtors in the

amount of $731,367.74 plus interest. The Defendant-Debtors had also asked in their Motion that a new trial of the adversary proceeding be granted and that the Bankruptcy Judge be disqualified. The Defendant-Debtors had argued that because the Bankruptcy Judge had voluntarily executed affidavits at the request of the Defendant-Debtors' former bankruptcy attorneys, both before and after the trial of this matter, in a proceeding that the Defendant-Debtors had initiated with the Disciplinary Review Board of the Supreme Court of Tennessee against their former bankruptcy attorney, his "impartiality might reasonably be questioned," he had developed a personal bias against the Defendant-Debtors, and he should therefore have disqualified himself from the hearing of the adversary proceeding. Based upon statements of counsel for the respective parties, based upon the oral findings of fact and conclusions of law announced in open Court including the finding

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that the affidavits in question related to only factual observance of events occurring in open Court, and based upon the entire record in this joint Section 302 case, the Court finds that the Motion of the Defendant-Debtors should be denied.

IT IS SO ORDERED.

/s/ DAVID L.KENNEDY
Chief Bankruptcy Judge
Date: January 10, 1992,
nunc pro tunc for the
Honorable William B. Leffler,
Chief United States Bankruptcy
Judge (deceased as of the
prior date)

APPROVED:

/s/ John D. Horne
Attorney for Defendant-Debtors

/s/ F. Guthrie Courtland
Attorney for Barclays American
Business Credit, Inc.

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APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

BARCLAYS/AMERICAN BUSINESS
CREDIT, INC.,

Plaintiff/Appellee Civil No. 87-2203
Todd

v. Bankr. No. 84-23849
Adv. No. 85-0357

EDSEL ADAMS and
FRANCES T. ADAMS,

Defendants/Appellants.

ORDER PARTIALLY AFFIRMING DECISION
OF BANKRUPTCY COURT AND REMANDING
FOR FURTHER PROCEEDINGS

On October 9, 1984, Edsel Adams and Frances T. Adams filed an original petition under Chapter 7 of the Bankruptcy Code in the United States Bankruptcy Court for the Western District of Tennessee, Western Division.[1] On May 11, 1985, Plaintiff/

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[1] Adams Plywood, a corporation wholly owned by Edsel Adams, filed a petition under Chapter 11 of the Bankruptcy Code on August 22, 1984.

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Appellee, Barclays/ American Business Credit, Inc. ("Barclays") filed an adversary complaint against the Debtors. Barclays sought a denial of discharge pursuant to 11 U.S.C. §§ 727(a)(2)-(7), a determination that the debt owed to it was nondischargeable pursuant to 11 U.S.C. §§ 523(a)(2) & (4), and a nondischargeable judgment in the amount of $400,000 plus costs. A lengthy trial was held, beginning on April 21, 1986. On June 18, 1986, the bankruptcy court issued a memorandum opinion and order denying the Debtors a discharge pursuant to § 727(a)(2); the court found that this determination made it unnecessary to consider the question of nondischargeability under § 523. Judgment was subsequently entered for Barclays on June 27, 1986, including a money judgment in the amount of $731,367.74 plus interest. The Debtors filed a notice of appeal from the order and the judgment on July 7, 1986.

On June 27, 1986, Barclays filed a motion for clarification of the bankruptcy court's memorandum opinion and order. On October 3, 1986, the bankruptcy court issued an order making two additional findings: 1) that pursuant to the security agreement between the parties, the disposition of the Debtors' assets and Barclays' collateral was governed by North Carolina law, and 2) that Barclays' disposed of its collateral in a commercially reasonable manner. The Debtors filed a notice of appeal on October 14, 1986, stating that they were appealing the June 18 order and the June 27, judgment, as amended.

On November 24, 1986, the Debtors filed a motion to reopen the case, for a new trial, and to disqualify the bankruptcy judge on the grounds of a personal bias, prejudice, and questionable impartiality. The bankruptcy court denied the motion by order of March 4,

1987.[2] On March 9, 1987, the Debtors filed a notice of appeal from that order.

Appellants raise five issues on appeal:

1) Whether the bankruptcy court erred in denying the Debtors' a discharge pursuant to 11 U.S.C. § 727(a)(2).

2) Whether the bankruptcy court erred in finding that Barclays disposed of its collateral in a commercially reasonable manner.

3) Whether the bankruptcy court erred in awarding Barclays a nondischargeable money judgment in the amount of $731,367.74 plus interest.

4) Whether the amount of the money judgment, including the assessment of legal fees and expenses, was supported by the proof.

5) Whether the bankruptcy judge should have reopened the case, granted a new trial and disqualified himself on the basis of personal bias, prejudice, or questioned impartiality.

For the reasons set forth below, the decision of the bankruptcy court is partially affirmed, and the case is remanded.

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[2] The order was entered on January 10, 1992, nunc pro tunc to the filing date of the original order.

The factual findings of a bankruptcy court should not be overturned on appeal by a district court unless they are clearly erroneous. In re: Southern Industrial Banking Corp., 809 F.2d 329, 331 (6th Cir. 1987); Bankr. Rule 8013. Under this standard, so long as the judge's inferences are reasonable and supported by the evidence, they will not be disturbed. Southern Industrial, 809 F.2d at 331. Questions of law are reviewed *de novo*.

I. DENIAL OF DISCHARGE

The bankruptcy court held that the Debtors should be denied a discharge pursuant to 11 U.S.C. § 727(a)(2). The Debtors contend that this ruling was erroneous for several reasons. First, it is contended that certain assets alleged to have been transferred or concealed were not "property

of the debtor" as required by the statute.

§727(a)(2) provides:

> (a) The court shall grant the debtor a discharge, unless --
>
> (1) ...
>
> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed --
>
> (A) property of the debtor, within one year before the date of the filing of the petition; or
>
> (B) property of the estate, after the date of the filing of the petition;

The bankruptcy court based its denial of discharge in part on the Debtors' transfer of collateral accounts receivable held by Adams Plywood ("AP"), a corporation in which Mr. Adams was the sole stockholder. These accounts receivable were subject to Barclays validly perfected security interest, and

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under the security agreement collections were required to be deposited into an account over which only Barclays had withdrawal authority (the "dominion" account). The bankruptcy court found that the Debtors, without authorization from Barclays, deposited approximately $150,000 in collections into AP's operating account, rather than the dominion account. The Debtors contend that these collections were the property of AP as a corporation, and therefore cannot constitute "property of the debtor" under § 727(a)2)(A) as to them in their individual capacities.

As part of the security agreement with Barclays, the Debtors executed personal guarantees of the AP debt. In addition, as Mr. Adams was the sole owner and decisionmaker of the corporation, AP was an

"insider"[3] of the Debtors under §727(a)(7).[4] See In re: Powell, 88 B.R. 114 (Bankr. W.D. Tex. 1988). The circumstances in this case are similar to those in Powell, in which the court stated:

> Section 727(a)(7) makes an individual debtor liable to the extent he or she engages in conduct on behalf of an insider which violates any of the first six subsections of Section 727(a).

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[3] 11 U.S.C. § 101(31)(A) provides that an "insider" of an individual includes:

(i) relative of the debtor or of a general partner of the debtor;

(ii) partnership in which the debtor is a general partner;

(iii) general partner of the debtor;

(iv) corporation of which the debtor is a director, officer, or person on control.

[4] § 727(a)(7) provides:

(a) The court shall grant the debtor a discharge, unless --(7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider;

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> Powell, as both 90% owner, officer, operator and prime employer of Fine Jewelry, was the human person who was the actor and decisionmaker for the corporate person, Fine Jewelry. Fine Jewelry is an insider under the Bankruptcy Code. 11 U.S.C. § 101([31]). Thus, if Fine Jewelry can be said to have violated any of the provisions of Section 727(a), it did so by and through C.B. Powell. The failure of Fine Jewelry to either account for the deterioration of its inventory or preserve its records so that that determination could be made must ultimately be the responsibility of its owner and operator ... For this reason, the Court concludes that Fine Jewelry through its principal ... has run afoul of subsections (a)(3) and (a)(5) of Section 727, thereby rendering Powell vulnerable under Section 727(a)(7). Powell's discharge will therefore be denied.

88 B.R. at 117. See also Ford Motor Credit Co. v. Owens, 807 F.2d 1556, 1559-60 (11th Cir. 1987).

The Adams' action on behalf of AP are attributable to them personally because Mr. Adams was the owner and operator of the corporation, and both Mr. and Mrs. Adams personally guaranteed the AP debt. Therefore, the Adams' transfer and

concealment of approximately $150,000 of AP's accounts receivable collections were properly considered by the bankruptcy court, via §727(a)(7), in determining whether a violation of § 727(a)(2) occurred.

The Debtors next maintain that the bankruptcy court was clearly erroneous when it found that $99,378.42 was transferred, post-petition, from AP's operating account into a personal account, and that $62,354.31 was subsequently disbursed from that account. Debtors argue that the funds were transferred into a corporate account, not a personal account. However, even if that finding is erroneous, the type of account into which the funds were deposited is relevant. The crux of the bankruptcy court's findings was that the transfer and subsequent disbursement were unauthorized use of cash collateral. That finding is not affected by whether the account was corporate or personal, and this

court cannot say that it is clearly erroneous.

The Debtors also argue that the bankruptcy court found their explanation for the use of AP's cash collateral to be reasonable, and that a denial of discharge is inconsistent with that finding. However, the court actually found that "[t]he explanations of the Adamses for their depositing collected funds into the operating account and failing to remit same to Barclays' dominion account are reasonable. However, the separate testimonies of the Barclays' officials does much to discredit them." The bankruptcy court obviously found the Debtors' explanation reasonable on its face, but less than credible when considered in light of the testimony as a whole. This argument is meritless.

The Debtors also appeal to the court's discretion to grant a discharge even if it is determined that grounds for a denial exist,

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citing Matter of Jones, 67 B.R. 484 (Bankr. W.D. Mo. 1985). However, Jones involved a large debt and a relatively small fraudulent transfer, plus other equitable considerations. None of those factors are present in this case. See Matter of Hacker, 90 B.R. 994, 997 (Bankr. W.D. Mo. 1987).

Lastly, the Debtors contend that Barclays was required to prove the Debtors' intent under § 727(a)(2) by clear and convincing evidence, and that it failed to do so. Under § 727, the burden of proving an objection to discharge is on the objector. However, there is a split of authority as to whether an objection must be proved by clear and convincing evidence[5] or whether the

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[5] See, e.g., In re: Overmyer, 121 B.R. 272, 279-80 (Bankr. S.D.N.Y. 1990); In re: Zell, 108 B.R. 615, 623 (Bankr. S.D. Ohio 1989); In re: Dias, 95 B.R. 419, 421 (Bankr. N.D. Tex. 1988); In re: Woerner, 66 B.R. 964, 972 (Bankr. E.D. Pa. 1986); In re: Ford, 53 B.R. 444, 449 (Bankr. W.D. Va. 1985), aff'd, 773 F.2d (4th Cir. 1985).

burden is satisfied by a preponderance of the evidence.[6] Indeed, one court of appeals has issued conflicting opinions on this question. Compare In re: Adlman, 541 F.2d 999, 1005 (2d Cir. 1976) (objection to discharge must be proved by convincing evidence) with In re: Robinson, 506 F.2d 1184, 1187 (2d Cir. 1974) (fair preponderance of the evidence is sufficient under § 727. The Sixth Circuit Court of Appeals has not ruled on the issue.

The United States Supreme Court, in Grogan v. Garner, --- U.S. ---, 111 S.Ct. 654 (1991), held that a preponderance of the evidence standard, rather than a clear and convincing evidence standard, applies to all

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[6] See e.g., In re: Shults, 28 B.R. 395, 396 (Bankr. 9th Cir. 1983); Matter of Ayala, 107 B.R. 271, 274 (Bankr. E.D. Cal. 1989); In re: Parker, 85 B.R. 384, 387 (Bankr. E.D. Va. 1988), aff'd, 879 F.2d 863 (4th Cir. 1989); In re: Riso, 74 B.R. 750, 757 (Bankr. D.N.H. 1987); In re: Clausen, 44 B.R. 41, 45 (Bankr. D. Minn. 1984).

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exceptions to discharge under 11 U.S.C. § 523(a). The Court stated:

> Because of the preponderance-of-the-evidence standard results in a roughly equal allocation of the risk of error between litigants, we presume that this standard is applicable in civil actions between private litigants unless "particularly important individual interests or rights are at stake." We have previously held that a debtor has no constitutional or "fundamental" right to a discharge in bankruptcy ...
>
> We are unpersuaded by the argument that the clear-and-convincing standard is required to effectuate the "fresh start" policy of the Bankruptcy Code ... the Act limits the opportunity for a completely unencumbered new beginning to the "honest but unfortunate debtor."

111 S.Ct. at 659 (citations omitted).

Although Grogan deals with § 523(a), this court finds that the Supreme Court's rationale applies with equal force to objections under § 727. Other courts have concurred. See In re: Cook, 126 B.R. 261, 265-66 (Bankr. E.D. Tex. 1991); In re: Hall, 126 B.R. 117, 119-20 (Bankr. M.D. Fla. 1991); In re: Davis, 124 B.R. 831, 835 (Bankr. D. Kan. 1991); cf. In re: Urban, 130 B.R. 340,

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344 (Bankr. M.D. Fla. 1991); In re: Goldstein, 123 B.R. 514, 520 n.14 (Bankr. E.D. Pa. 1991). Therefore, Barclays needed to prove their objection to discharge only by a preponderance of the evidence. The bankruptcy court presumably found that that standard had been satisfied, and that the discharge should be denied.

After a thorough review of the record, this court holds that the bankruptcy court's findings of fact with regard to § 727(a)(2) are not clearly erroneous. The bankruptcy court had before it the Debtors' unauthorized transfer of collected accounts receivable into the AP operating account, the unauthorized post-petition transfer and use of cash collateral, a $12,000 check drawn on the Debtors' personal account and cashed by Mrs. Adams six weeks prior to the date of filing, and a transfer by Mrs. Adams of $4,404.50 worth of her husband's paychecks into a bank account in her maiden name

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approximately one month prior to filing. This evidence supports a finding that the Debtors intended to hinder, delay, or defraud their creditors. Therefore, the denial of discharge is affirmed.

II. COMMERCIAL REASONABLENESS

Under the security agreement entered into between Barclays and the Debtors, Barclays was granted a security interest in the inventory of Adams Plywood, as well as in the accounts receivable. On October 22, 1984, the Debtors and Barclays entered into an agreement whereby the Debtors would abandon the inventory, and the automatic stay would be lifted in order to permit a foreclosure sale by Barclays. The agreement contained a provision that a minimum of $250,000 in net proceeds would be realized from the sale and applied to the Adams' indebtedness, even if the actual amount realized was less than $250,000. The

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foreclosure sale was conducted on November 28, 1984, in Birmingham, Alabama. As no bid higher than $250,000 was received, Barclays became the successful bidder at the guaranteed amount. The Debtors now contend that the bankruptcy court erred in holding that the foreclosure sale was conducted in a commercially reasonable manner.

The security agreement between the parties expressly provided that it was to be governed by North Carolina law, and the bankruptcy court so found. Under North Carolina law, a sale of collateral is conclusively deemed to be commercially reasonable in all aspects if the provisions of N.C. Gen. Stat. §§ 25-9-601 to 607 are substantially complied with.[7] The

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[7] N.C. Gen. Stat §§ 25-9-601 to -603 provides in relevant part:

§ 25-9-601--Disposition of collateral by public proceedings ... may be made in accordance with the provisions of this (continued...)

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bankruptcy court found that Barclays had

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[7](...continued)

part. The provisions of this part are not mandatory ..., but any disposition of the collateral by public sale wherein the secured party has substantially complied with the procedures provided in this part shall conclusively be deemed to be commercially reasonable in all aspects.

§ 25-9-602--The notice of sale shall substantially:

(a) Refer to the security agreement pursuant to which the sale is held;

(b) Designate the date, hour and place of sale ...

(c) Describe personal property to be sold substantially as it is described in the security agreement ... and may add such further description as will acquaint bidders with the nature of the property;

(d) State the terms of the sale provided by the security agreement ... including the amount of the cash deposit, if any, to be made by the highest bidder at the sale;

§ 25-9-603--

(1) In each public sale conducted hereunder, the notice of sale shall be posted on a bulletin board provided for the posting of such legal notices, in the courthouse, in the county in which the sale is to be held, for at least five days immediately preceding the sale.

(2) In addition to the posting of notice ...the secured party ...shall, at least five days before the date of sale, mail by registered or certified mail a copy of the notice of sale to each debtor obligated under the security agreement ....

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complied with all the requirements of the statute, and applied the presumption of commercial reasonableness.

The Debtors contend that there is no evidence that a notice of public sale was ever posted in the appropriate county courthouse as dictated by § 25-9-603(1). However, the record clearly shows otherwise. Herbert Falk, Jr., an attorney for Barclays, testified that on November 20, 1984, he caused the notice of public sale to be posted in the Jefferson County courthouse in Birmingham, Alabama. TR 558. This evidence is unrefuted. The record also contains evidence that Barclays complied with the remaining statutory requirements. Therefore, the findings of the bankruptcy court are not clearly erroneous, and the presumption of commercial reasonableness was correctly applied.

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III. MONEY JUDGMENT

The bankruptcy court awarded Barclays a nondischargeable money judgment in the amount of $731,367.74 plus interest. The Debtors contend that this judgment was erroneous. First, it is argued that the amount of damages awarded by the bankruptcy court cannot be upheld because the ad damnum clause in the amended complaint is only for $400,000. However, paragraph five of the amended complaint alleges an unpaid balance exceeding $800,000. In addition, no objection was made at trial to the admission of evidence concerning damages in amounts in excess of $400,000. Therefore, the issue was tried by consent pursuant to Fed. R. Civ. p. 15(b) and Bankr. Rule 7015, and may not be complained of on appeal.

The Debtors also contend that the damage award is improper because it is speculative in amount, and because it contains an

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excessive award of attorneys' fees and expenses. However, in Story Parchment Co. v. Patterson Parchment Paper Co., 282 U.S. 555 (1931), the Supreme Court stated:

> [T]here is a clear distinction between the measure of proof necessary to establish the fact that petitioner had sustained some damage, and the measure of proof necessary to enable the jury to fix the amount. The rule which precludes the recovery of uncertain damages applies to such as are not the certain result of the wrong, not to those damages which are definitely attributable to the wrong and only uncertain in respect of their amount.

282 U.S. at 562. Accord Broan Mfg. Co., Inc. v. Associated Distributors, Inc., 932 F.2d 1232, 1235, (6th Cir. 1991). As it is clear from the record that Barclays sustained substantial damages, a sizable money judgment would be appropriate.

The Debtors maintain that a large portion of the judgment constituted an improper award of attorneys' fees. it is argued that Barclays may be awarded attorneys' fees only for work associated with

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the bankruptcy proceedings. However, contrary to these assertions, a creditor is entitled to recover attorneys' fees in bankruptcy if there is a contractual right to them under the governing state law. Such a contractual right to attorneys' fees is part of the debt, and may be recovered accordingly. See In re: Martin, 761 F.2d 1163, 1168 (6th Cir. 1985); In re: Bain, 527 F.2d 681, 685 (6th Cir. 1975).

North Carolina law provides:

> Obligations to pay attorney's fees upon any ... evidence of indebtedness ... shall be valid and enforceable, and collectible as part of such debt ...: (1) If such ... evidence of indebtedness provides for attorneys' fees in some specific percentage of the "outstanding balance" as herein defined, such provisions and obligation shall be valid and enforceable up to but not in excess of fifteen percent (15%) of said "outstanding balance" owing on said ... evidence of indebtedness.
>
> (2) If such ... evidence of indebtedness provides for the payment of reasonable attorneys' fees by the debtor, without specifying any specific percentage, such provision shall be construed to mean fifteen percent (15%

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> of the "outstanding balance" owing on said ... evidence of indebtedness.

N.C. Gen. Stat. § 6-21.2(1)-(2). The promissory note upon which the indebtedness in this case is based stated:

> In the event that this note shall at any time after maturity be placed with an attorney for collection, debtor agrees to pay in addition to the entire remaining principal balance and accrued interest a reasonable sum but not more than 15% of said principal balance and interest as and for attorneys' fees, if allowed by law.

In addition, the guarantee signed by the Debtors provides:

> Guarantor agrees to pay all expenses incurred by lender in connection with enforcement of its rights under this guarantee, as well as court costs, collection charges and attorneys' fees and disbursements.

Barclays clearly is entitled to recover reasonable attorneys' fees and expenses, not to exceed fifteen percent of the "outstanding balance" owed on the debt. However, under North Carolina law it is incumbent upon the trial court to make specific findings as to the reasonableness of an award of fees and

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expenses. Baker v. Agee, 378 S.E.2d 566, 570 (N.C. Ct. App. 1989); Coastal Prod. Credit Ass'n v. Goodson Farms, Inc., 319 S.E.2d 6540, 656 (N.C. Ct. App. 1984). The bankruptcy court did not specify how much of the judgment constituted attorneys' fees and expenses, and did not inquire as to the reasonableness of those fees and expenses. Therefore, the case must be remanded for this determination. As part of the reasonableness inquiry, the bankruptcy court should determine whether the fifteen percent cap on the fee award should be calculated on the outstanding balance of the debt at the time Barclays brought suit on the Debtors' personal guarantee in United States District Court in North Caroline, or on the outstanding balance at the time the adversary complaint in this bankruptcy was filed.[8]

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8 N.C. Gen. Stat § 6-21.2(3) provides:

(continued...)

affected his opinion in the case, and denied the motion.

Subsequent to the filing of the adversary complaint in this case, the Debtors and their original counsel of record, Philip T. Shanks, III and Ronald T. Riggs, became involved in a disciplinary proceeding before the Board of Professional Responsibility of the Tennessee Supreme Court. The Debtors alleged that in the Barclays adversary proceeding, during a hearing before Judge Leffler on September 12, 1985, Mr. Shanks in some way touched, intimidated, threatened, or otherwise harmed Mrs. Adams. It was also alleged that Mr. Riggs and Mr. Shanks had "sold out" in the bankruptcy proceeding, conspiring to deprive the Debtors of their rights under the bankruptcy code.

Judge Leffler, on behalf of Mr. Shanks and Mr. Riggs, submitted two affidavits to the Board of Professional Responsibility. In the first, he stated that during the hearing

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on September 12, 1985, he observed no conduct on the part of Mr. Shanks such as had been alleged. In the second affidavit he stated that he had seen no evidence of and had observed no wrongdoing on the part of either Mr. Shanks or Mr. Riggs during the bankruptcy proceedings. The Debtors contend that these affidavits are evidence of a personal bias or prejudice on the part of Judge Leffler, and that his impartiality was questionable. 28 U.S.C. § 455 provides in relevant part:

> (a) Any justice, judge, or magistrate of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.
>
> (b) He shall also disqualify himself in the following circumstances:
>
> (a) Where he has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding;

Bias sufficient to justify recusal must be personal, stemming from an extrajudicial source, and must "result in an opinion on the

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merits on some basis other than what the judge learned from his participation in the case." United States v. Grinnell Corp., 384 U.S. 563, 583 (1966). See also Garver v. United States, 846 F.2d 1029, 1031 (6th Cir. 1988); First Nat'l Monetary Corp. v. Weinberger. 819 F.2d 1334, 1337 (6th Cir. 1987); In re: M. Ibrahim Khan, P.S.C., 751 F.2d 162, 164 (6th Cir. 1984).

The affidavits submitted by Judge Leffler on behalf of Mr. Shanks and Mr. Riggs contained no information of an extrajudicial nature, and no indication that the Judge had obtained such information. The affidavits merely state the Judge Leffler's impressions of the evidence before him, and his recollection of conduct which he observed in court proceedings. These perceptions cannot be the basis for an allegation of bias.

The Debtors point to several adverse rulings by Judge Leffler as evidence of his questionable impartiality. However, the mere

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fact that a judge has ruled against a litigant is not evidence of prejudice. There are no facts in the record which would lead a reasonable person to doubt Judge Leffler's impartiality. The denial of the motion to reopen case, for a new trial, and to disqualify is affirmed.

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V. CONCLUSION

In summary, the court hereby affirms the bankruptcy court's denial of the Debtors' discharge, and finding that Barclays disposed of its collateral in a commercially reasonable manner, and the denial of the motion to disqualify the bankruptcy judge. The case is remanded for further proceedings with regard to attorneys' fees, in accordance with part III of this opinion.

IT IS SO ORDERED.

/s/ JAMES D. TODD
UNITED STATES DISTRICT JUDGE

Date: January 30, 1992

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APPENDIX E

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

EDSEL AND FRANCES T. ADAMS,

Case. No. 84-23849

Debtors.

BARCLAYS BUSINESS
CREDIT, INC.,
F/K/A BARCLAYS/AMERICAN
BUSINESS CREDIT, INC.

Plaintiff,

v.

Adversary Proceeding
No. 85-0357

EDSEL ADAMS and
FRANCES T. ADAMS,

Defendants.

ORDER AMENDING JUDGMENT ENTERED
JUNE 27, 1986
(Filed November 24, 1992)

This matter came on before the Court for hearing on Monday, November 16, 1992, upon remand from the United States District Court for the Western District of Tennessee, and upon statements of counsel for Barclays Business Credit, Inc. ("Barclays") and the Debtors, it appears to the Court as follows:

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1. By Memorandum Opinion and order dated June 18, 1986, and Judgment entered June 27, 1986, Barclays obtained a nondischargeable money judgment against the Debtors in the amount of $731,367.74, plus interest.

2. The Debtors appealed the Order and Judgment, and on January 30, 1992, the District Court entered an Order Partially Affirming Decision of Bankruptcy Court and Remanding for Further Proceedings. The matter was remanded to this Court to determine the amount of attorneys' fees and collection costs to which Barclays was entitled as a part of the original judgment.

3. Although the original judgment included $134,648.49 in attorneys' fees and collection costs, with the consent of Barclays and its counsel, the Court determines that attorneys' fees and collection costs in the amount of $89,507.89 are reasonable.

4. Therefore, the original judgment is hereby amended and Barclays is hereby granted

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a judgment in the amount of $686,227.14, plus post-judgment interest on that amount since June 27, 1986.

SO ORDERED this 24th day of November, 1992.

/s/ WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

APPROVED BY:

/s/ David J. Cocke
BOROD & KRAMER
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Memphis, TN 38119
(901)685-9222
Attorney for Debtors

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APPENDIX F

RECOMMENDED FOR FULL-TEXT PUBLICATION
Pursuant to Sixth Circuit Rule 24

ELECTRONIC CITATION: 1994 FED App. 0278P (6th Cir.)
File Name: 94a0278p.06

No. 93-5447

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re: EDSEL ADAMS and FRANCES T. ADAMS,
Debtors.

BARCLAYS/AMERICAN BUSINESS CREDIT, INC.,
Plaintiff-Appellee,

v.

EDSEL ADAMS and FRANCES T. ADAMS,
Defendants-Appellants.

} ON APPEAL from the United States District Court for the Western District of Tennessee

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Decided and Filed August 3, 1994

Before: KEITH and MARTIN, Circuit Judges; and KRUPANSKY, Senior Circuit Judge.

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BOYCE F. MARTIN, JR., Circuit Judge. Edsel and Frances T. Adams appeal the decision of the district court affirming the bankruptcy court's denial of a discharge under 11 U.S.C. § 727(a)(2)(A) and (a)(2)(B), and imposition of a $686,227.14 money judgment, plus interest, in favor of Barclays/American Business Credit, Inc.. The Adamses maintain, under Section 727, that they did not hinder or delay collection of their debt, and argue that Barclays did not dispose of their inventory in a commercially reasonable manner. The Adamses also contend that the bankruptcy judge was biased against them, and should have recused himself pursuant to 28 U.S.C. § 455. The district court rejected each of these arguments. For the following reasons, we affirm the judgment of the district court.

I

During the 1980s, Edsel and Frances Adams wholly owned and controlled three corporations operating in Alabama and Arkansas: Adams Plywood, Inc., West Memphis Plywood Corporation, and Magic City Plywood. Adams Plywood sold hardwood veneer plywood, which was manufactured at two plant sites controlled by Adams Plywood and West Memphis Plywood. Adams Plywood owned all of the inventory at both plant sites. Magic City Plywood was a wholesale plywood distributor that usually bought materials exclusively from Adams Plywood for resale to small cabinetmakers.

Barclays/American Business Credit, Inc., is a commercial lender that supplied operating capital to Adams Plywood under the terms of a secured lending agreement dated July 26, 1983. Pursuant to the agreement, Barclays advanced funds to the Adamses based on the Adamses' pledge of accounts receivable and inventory. Each time they made shipments on credit to their customers, the Adamses filled out Barclays pledge reports indicating the creation of an account receivable. They then received an immediate eighty-five percent cash advance on that account. Upon collection of the account, the Adamses

were required to report the receipt of funds to Barclays and to deposit the proceeds into a "dominion account" at a Memphis, Tennessee bank, from which account only Barclays could withdraw money. The proceeds were credited to the loan balance, thereby reducing the Adamses' indebtedness. Barclays also agreed to advance amounts of up to fifty percent of the value of the Adamses' inventory, with the inventory serving as collateral. All of these lending arrangements were personally guaranteed by the Adamses.

In the fall of 1983, the Adamses began experiencing financial difficulties. In order to make payments to their suppliers, the Adamses, without Barclays' knowledge or permission, transferred inventory in which Barclays had a security interest to unsecured creditors in lieu of cash. The Adamses effectuated this transfer because the West Memphis plant had ceased operations in December, due to a default on a $250,000 bond with the City of West Memphis. In early December, the Adamses also transferred their only unencumbered assets, Magic City Plywood stock and a property in Abbeville, Alabama, to their daughters for no consideration.

By February 1984, some of Adams Plywood's suppliers were submitting unfavorable credit reports, and the Adamses were having difficulty collecting on their accounts receivables. Under the loan agreement, accounts not collected within sixty days became ineligible as collateral, and reduced the amount of advances that could be made against new accounts. Adams Plywood was also accumulating an inventory of unsold goods, which originated from the West Memphis plant that had been shut down in December. Much of this inventory was apparently of less than "top grade" quality, which had a direct effect on sales. Barclays representatives Michael Faircloth and Barry Johnson met with Edsel Adams on March 26, and warned him that the lending agreement would have to be reassessed if these trends continued. By April, Adams Plywood had a serious cash flow problem. In mid-August, Barclays notified the Adamses that it would insist on a plan

of orderly inventory liquidation, to begin on September 1, if their cash flow situation did not improve.

On August 22, Adams Plywood filed for Chapter 11 bankruptcy protection. A subsequent audit of the company's books and records revealed that by August 21, the Adamses had deposited $150,000 in Adams Plywood accounts receivables in their corporate bank account, rather than in Barclays' dominion account as required by the loan agreement. The Adamses kept these deposits secret through the use of a "check-kiting" scheme, which involved falsely reporting "contemporaneous collections," drawn on the corporate account and deposited in the dominion account well after the collection actually occurred, while keeping the corporate account solvent by depositing new customer collections therein. Through the use of this scheme, the Adamses were able to delay reports and payments to Barclays.

The audit also revealed that, in the two weeks after the Chapter 11 filing, the Adamses opened a checking account in a Memphis Bank with $99,000 in funds drawn from the Adams Plywood corporate account, and subsequently withdrew $49,000 from this checking account. The proceeds of a $15,000 check from Magic City Plywood were also unaccounted for. On September 6, Barclays obtained a temporary restraining order from the bankruptcy court prohibiting further unauthorized, post-petition disbursements from these accounts. After unsuccessfully demanding that the Adamses pay their debt in full, Barclays filed suit in North Carolina district court on September 21, seeking payment pursuant to the Adamses' personal guarantees. This action by Barclays caused the Adamses, in turn, to file a Chapter 7 bankruptcy petition on October 9.

Further investigation by Barclays subsequently revealed that on August 28, Mrs. Adams had cashed a $12,000 check with funds from the Adamses' personal bank account, and deposited that money, along with her husband's paychecks, in a new account opened in her

maiden name at another bank. The Adamses used this money, in part, to pay living expenses and their bankruptcy attorney at the time. The Adamses also apparently converted almost $10,000 of the Chapter 7 estate after the filing of the petition.

On November 20, the Adamses filed a "Schedule of Affairs" with the bankruptcy court in which they made numerous material misrepresentations regarding their pre- and post-petition transactions. The Adamses subsequently agreed to abandon their inventory to Barclays for a minimum $250,000 credit on their debt. After conducting a public sale, Barclays took possession of the inventory for the agreed-upon $250,000 because no higher bid was received. Barclays then filed the present adversary action on May 11, 1985, asking the bankruptcy court for a finding that the remainder of the Adamses' debt was non-dischargeable, and also seeking a money judgment.

After a lengthy trial, the bankruptcy court rendered its decision on June 18, 1986. The bankruptcy court refused to void the Adamses' pre-petition transfers of the Abbeville property and the Magic City stock to their daughters, as the transfers were not voidable under the terms of 11 U.S.C. § 548(a). The bankruptcy court also found, however, that the remainder of the Adamses' financial activities were conducted with the intent to hinder or delay creditors within the meaning of 11 U.S.C. § 727(a)(2)(A) and (a)(2)(B). The court thus denied the Adamses a discharge of their debts under Chapter 7. On June 27, the bankruptcy court entered judgment for Barclays in the amount of $731,367.74, and the Adamses appealed.

Barclays subsequently filed a motion for clarification in the bankruptcy court, asking for a finding that its disposition of collateral was commercially reasonable, and requesting that the court make additional dischargeability findings under 11 U.S.C. § 523(a)(2) and (a)(4). On October 3, the court ruled that Barclays disposed of the collateral in a commercially reasonable manner pursuant to North Carolina General Statute § 25-9-601 *et seq.*, which

was the controlling law under the security agreement. The court declined to make alternative dischargeability findings under Section 523(a) of the Bankruptcy Code.

On October 14, the Adamses filed a revised notice of appeal, referencing both of the bankruptcy court's orders, in the United States District Court for the Western District of Tennessee. On November 24, the Adamses filed a motion in the bankruptcy court to reopen the case for a new trial, and to disqualify the bankruptcy judge on the grounds of personal bias, prejudice, and questionable impartiality. The bankruptcy court denied this motion on March 4, 1987. On March 9, the Adamses filed a notice of appeal from this decision, and the district court subsequently consolidated all of the Adamses' appeals. On January 30, 1992, the district court affirmed the bankruptcy court as to the merits on all counts, but remanded the case for a particular accounting of attorney's fees and costs. In accordance with the district court's order, the bankruptcy court revised its calculations and imposed a money judgment of $686,227.14. The district court then amended its previous order to incorporate the bankruptcy court's revised ruling, and certified the amended judgment as final and appealable on March 22, 1993. This timely appeal followed.

II

The Adamses maintain that Barclays did not meet its burden of proving hindrance, delay or fraud by clear and convincing evidence, and assert that the bankruptcy court thus erred in denying them a general discharge under 11 U.S.C. § 727(a)(2)(A) and (a)(2)(B). Section 727, in relevant part, provides that:

> (a) The Court shall grant the debtor a discharge, unless--
>
> . . .
>
> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate

> charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed--
>
> > (A) property of the debtor, within one year before the date of the filing of the petition; or
> > (B) property of the estate, after the date of the filing of the petition; . . .

A bankruptcy court's finding of hindrance, delay, or fraud is a factual finding, which we review for clear error. *Longo v. McLaren (In re McLaren)*, 3 F.3d 958, 960-61 (6th Cir. 1993).

Here, the parties disagree with respect to the appropriate burden of proof under Section 727. The Adamses maintain that Barclays bears the burden of proving a Section 727 exception by clear and convincing evidence, while Barclays asserts that it is only required to prove such an exception by a preponderance of the evidence. The bankruptcy court did not explicitly apply either of these standards in finding that "Barclays has met the burden of conclusively showing that the Adamses actually intended to hinder or delay the collection of its debt by [their] pre and post-petition transfers."[1]

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[1]The bankruptcy court relied on two prior bankruptcy court decisions involving fraud for the proposition that a creditor must "conclusively show" hindrance or delay under Section 727(a)(2). *See In re Cycle Accounting Services*, 43 B.R. 264 (Bankr. E.D. Tenn. 1984); *In re Porter*, 37 B.R. 56 (Bankr. E.D. Va. 1984). Interestingly enough, neither case appears to require a conclusive showing by the creditor. Instead, both hold that a creditor must make out a *prima facie* case of actual fraud, at which point the burden shifts to the debtor to come forth with a reasonable explanation, based on the facts and circumstances of the case, as to why there was no fraud. *Cycle Accounting Services*, 43 B.R. at 271; *Porter*, 37 B.R. at 63-64. In fact, the only mention of the word "conclusive" appears in *Porter*: "If such fraudulent intent is thus established *prima facie*, it must be regarded as conclusively established unless rebutted by facts and circumstances which are proven." *Porter*, 37 B.R. at 63-64. The

In *Grogan v. Garner*, 498 U.S. 279, 291 (1991), the Supreme Court held that a creditor must prove exceptions to dischargeability for individual debts under 11 U.S.C. § 523(a), including the exception for fraud, by a preponderance of the evidence. The Supreme Court reasoned as follows:

> Because the preponderance-of-the-evidence standard results in a roughly equal allocation of the risk of error between litigants, we presume that this standard is applicable in civil actions between private litigants unless "particularly important individual interests or rights are at stake." We have previously held that a debtor has no constitutional or "fundamental" right to a discharge in bankruptcy. . . .
>
> We are unpersuaded by the argument that the clear-and-convincing standard is required to effectuate the "fresh start" policy of the Bankruptcy Code . . . [T]he Act limits the opportunity for a completely unencumbered new beginning to the "honest but unfortunate debtor."

Id. at 286-87 (citations omitted). The Court's ruling in *Grogan* has retroactive effect, and thus we must consider whether its rationale is applicable to the present case. *In re Luce*, 960 F.2d 1277, 1281 (5th Cir. 1992).

The Sixth Circuit has not spoken regarding the appropriate burden of proof for a creditor under Section 727. Applying the *Grogan* rationale, three other circuits have held that a creditor must meet its burden of proof under Section 727 by only a preponderance of the evidence. *See Farouki v. Emirates Bank Int'l*, 14 F.3d 244, 250 n.17 (4th Cir. 1994); *In re Beaubouef*, 966 F.2d 174, 178 (5th Cir. 1992); *In re Serafini*, 938 F.2d 1156, 1157 (10th Cir. 1991). We believe that the Supreme

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district court assumed, without analysis, that the bankruptcy court actually applied a "preponderance of the evidence" standard to Section 727. Based upon our reading of the cases relied upon by the bankruptcy court, we agree with the district court's conclusion.

Court's reasoning in *Grogan* is equally applicable to Sections 523(a) and 727 of the Bankruptcy Code. Accordingly, we join our sister circuits in holding that the exceptions to dischargeability under Section 727, including the exception for fraud, require proof by a preponderance of the evidence.

Here, the bankruptcy court found that the Adamses transferred collected accounts receivable into the Adams Plywood operating account, used post-petition cash collateral, and made post-petition transfers of cash collateral, all without authorization. After carefully reviewing the record, we are convinced that these findings are not clearly erroneous. The bankruptcy court further found, based on the above events, that Barclays conclusively proved an intent to hinder or delay its collection of the Adamses' debt under Sections 727(a)(2)(A) and 727(a)(2)(B) of the Bankruptcy Code. We observe, in this regard, that the bankruptcy and district courts correctly characterized the Adams Plywood accounts receivables as "property of the debtor," under Section 727(a), because Edsel Adams controlled Adams Plywood.[2]

---

[2]Section 727(a)(7) of the Bankruptcy Code, 11 U.S.C. § 727(a)(7), provides as follows:

> (a) The Court shall grant the debtor a discharge, unless--
> (7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider; . . .

The term "insider" is defined in 11 U.S.C. § 101(31)(A)(iv):

> (31) "insider" includes--
> (A) if the debtor is an individual--
> . . .
> (iv) corporation of which the debtor is a director, officer, or

The bankruptcy court's finding of intentional delay or hindrance under this section is amply supported by the evidence, and we affirm the denial of discharge on those grounds.

III

The Adamses also contend that the bankruptcy court erred by applying a statutory presumption in finding Barclays' inventory sale to be commercially reasonable. The security agreement between the parties expressly provided that it was to be governed by North Carolina law, which establishes a conclusive presumption of commercial reasonableness for a sale of collateral if there has been substantial compliance with North Carolina General Statute Sections 25-9-601 through 25-9-607. The relevant parts of these statutory sections provide as follows:

> § 25-9-601 -- Disposition of collateral by public proceedings . . . may be made in accordance with the provisions of this part. The provisions of this part are not mandatory . . . , but any disposition of the collateral by public sale wherein the secured party has substantially complied with the procedures provided in this part shall conclusively be deemed to be commercially reasonable in all aspects.
>
> § 25-9-602 -- The notice of sale shall substantially:
> (a) Refer to the security agreement pursuant to which the sale is held;
> (b) Designate the date, hour, and place of sale . . . ;

---

person in control.

Edsel Adams wholly owned and controlled Adams Plywood. Adams Plywood thus qualifies as an insider, and the bankruptcy court was correct in considering the Adams Plywood accounts receivables to be property of the Adamses under Section 727(a)(2), by incorporation through Section 727(a)(7).

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(c) Describe personal property to be sold substantially as it is described in the security agreement . . . ; and
(d) State the terms of the sale provided by the security agreement . . . .

§ 25-9-603 --
(1) In each public sale conducted hereunder, the notice of sale shall be posted on a bulletin board provided for the posting of such legal notices, in the courthouse, in the county in which the sale is to be held, for at least five days immediately preceding the sale.
(2) In addition to the posting of notice . . . the secured party . . . shall, at least five days before the date of sale, mail a copy of the notice of sale to each debtor obligated under the security agreement.

N.C. Gen. Stat. §§ 25-9-601, 25-9-602, and 25-9-603. The bankruptcy court's finding of commercial reasonableness is a factual finding, and, as stated previously, we reverse such findings only if they are clearly erroneous. *McLaren*, 3 F.3d at 960-61.

In support of their contention that Barclays' inventory sale was commercially unreasonable, the Adamses present a veritable laundry list of nineteen separate allegations. Insofar as we are able to determine, only two of these allegations are related to the statutory requirements set forth above for a conclusive presumption of commercial reasonableness. The remainder of the allegations involve factors that, if established, would be relevant to an independent analysis of reasonableness, assuming that the statutory presumption did not apply.

The two "threshold" assertions made by the Adamses are that the notice of sale was not posted in timely fashion in the courthouse, and that the notice of sale described the sale site as that of Adams Plywood, while listing the address of Magic City Plywood. With respect to the first assertion, the record shows that Herbert Falk, Jr., an

attorney for Barclays, testified that he caused the notice of public sale to be posted on November 20, 1984, in the Jefferson County courthouse in Birmingham, Alabama. This testimony was unrefuted. Section 25-9-603(1) requires that the notice be posted at least five days prior to the sale; here, the notice was posted eight days prior to the sale, which took place on November 28.

With respect to the second assertion, the notice did describe the location of the sale as "the former place of business of the Debtor [Adams Plywood, Inc.]," and gave the street address of Magic City Plywood without naming that entity. The notice of sale, however, also mentioned that the collateral was then "located at two former places of business of the Debtor in Abbeville, Alabama, and one place of business in Birmingham, Alabama." The notice gave the correct street address of the sale, and, read as a whole, also stated that Barclays considered Adams Plywood to have more than one place of business. In this context, even a person who was familiar with Adams Plywood and Magic City Plywood as two separate entities would have understood, after reading the notice, that the juxtaposed references to Adams Plywood's "place of business" and the street address were not mutually exclusive descriptions. We conclude, based on the foregoing analysis, that the bankruptcy court did not clearly err in finding that Barclays had substantially complied with the statutory requirements for a conclusive presumption of commercial reasonableness. As the statutory presumption was properly established, the bankruptcy court correctly refused to consider the remainder of the Adamses' nineteen allegations. Thus, the bankruptcy court did not clearly err in finding that Barclays' inventory sale was commercially reasonable.

IV

The Adamses argue, finally, that the bankruptcy judge should have recused himself, pursuant to 28 U.S.C. § 455, because his impartiality might reasonably have been questioned by an objective observer. Before the trial in the

present case began, the Adamses filed a complaint against Philip Shanks and Ronald Riggs, their original bankruptcy counsel, with the Board of Professional Responsibility of the Tennessee Supreme Court. The complaint alleged that Shanks had touched, intimidated, or otherwise harmed Mrs. Adams during a hearing in the Barclays matter before Judge William B. Leffler, the bankruptcy judge, on September 12, 1985. The complaint further alleged that both Riggs and Shanks had "sold out" in the bankruptcy proceeding and conspired to deprive the Adamses of their rights under the Bankruptcy Code.

After trial, the Adamses discovered that Judge Leffler had executed two affidavits, on behalf of Shanks and Riggs, for the Board on November 25, 1985, and October 28, 1986. In the first affidavit, Judge Leffler stated that he did not personally observe any conduct by Shanks during the hearing such as that alleged, that he did not believe that such conduct could have occurred without his being aware of it, and that Shanks had consistently conducted himself in an honorable manner before the bankruptcy court. In the second affidavit, Judge Leffler stated that he had seen no evidence of a "sell-out," conspiracy, or other wrongdoing by either Shanks or Riggs, and further stated that both men had always conducted themselves in an honorable manner before the court.

The Adamses maintain that a reasonable person, knowing of these affidavits, would have questioned Judge Leffler's impartiality, and that recusal under 28 U.S.C. § 455(a) was therefore mandatory. They further contend that Judge Leffler had a personal, extrajudicial bias or prejudice against them, requiring recusal under either 28 U.S.C. § 455(a) or (b)(1). Section 455 states, in pertinent part, that:

> (a) Any justice, judge, or magistrate of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.
>
> (b) He shall also disqualify himself in the following circumstances:

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> (1) Where he has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding;

28 U.S.C. § 455. Barclays, relying on *United States v. Grinnell Corp.*, 384 U.S. 563 (1966), responds that the affidavits were neutral in tone, that they did not contain any material acquired by Judge Leffler from an extrajudicial source, and that recusal was thus unwarranted. In *Grinnell*, the Supreme Court held that recusal is inappropriate under Section 455(b) unless the judge's alleged bias stems from an extrajudicial source. *Grinnell*, 384 U.S. at 583.

The Supreme Court recently decided that the "extrajudicial source" analysis articulated in *Grinnell* applies to motions for recusal under Section 455(a) as well as Section 455(b). *Liteky v. United States*, 114 S. Ct. 1147, 1157 (1994). The Adamses contend that an objective appearance of impartiality, standing alone, is enough to require recusal under section 455(a). This contention is meritless given the additional, extrajudicial source analysis required by *Liteky*. As the Supreme Court explained in *Liteky*, 114 S. Ct. at 1157:

> [O]pinions formed by the judge on the basis of facts introduced or events occurring in the course of the current proceedings, or of prior proceedings, do not constitute a basis for a bias or partiality motion unless they display a deep-seated favoritism or antagonism that would make fair judgment impossible.

We review a trial judge's recusal decision under this standard for an abuse of discretion. *United States v. Sammons*, 918 F.2d 592, 599 (6th Cir. 1990); *cert. denied*, 114 S. Ct. 126 (1993).

Here, the opinions expressed in Judge Leffler's affidavits were formed on the basis of events occurring in the course of the current proceedings, as well as prior proceedings involving the Adamses' original bankruptcy counsel. The

affidavits were appropriately restrained in tone, were confined to the judge's personal observations of counsels' courtroom behavior, and were made in the context of a state bar disciplinary proceeding. Moreover, the affidavits do not display deep-seated favoritism towards Barclays, or antagonism towards the Adamses, in the slightest degree. Accordingly, we conclude that Judge Leffler did not abuse his discretion, under either 28 U.S.C. § 455(a) or (b)(1), in denying the Adamses' motion for recusal and a new trial.

V

For the foregoing reasons, the judgment of the district court is affirmed.

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